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Summary of the Economic and Social Survey of Asia and the Pacific 2015

Note by the Secretary-General

The Secretary-General has the honour to transmit herewith a summary of the *Economic and Social Survey of Asia and the Pacific 2015*.

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Summary of the Economic and Social Survey of Asia and the Pacific 2015

Summary

The year 2015 marks a watershed in global policymaking. It is the deadline for achieving the Millennium Development Goals, and it is expected that a set of sustainable development goals will be adopted in September to provide a framework for development policies beyond 2015. In view of these aspects, now is an opportune time to evaluate how successful the Asia-Pacific region has been in making economic growth more inclusive and sustainable. Therefore, the *Economic and Social Survey of Asia and the Pacific 2015* contains an examination of the economic growth performance in the region, highlighting the challenges that it is facing and with analyses of whether growth has benefited all people.

Economic growth in the developing economies of the region is expected to increase slightly in 2015. This outlook is primarily associated more with domestic and intraregional factors than with external factors. Despite the slight improvement in the economic outlook for the region, economic growth is not as high as it could be or has been in the past. The growth potential of the region's developing economies is being held back by structural weaknesses, such as infrastructure shortages and the excessive commodity-depoendence of some economies. The fragile global economic recovery is just an additional constraint that is not helping growth prospects. More importantly, there is concern that not all have shared equally in the benefits of economic growth; that is, it has not been sufficiently inclusive. Inequality of income as well as of opportunity has risen between different geographies and sections of society, such as in rural and urban areas and among women and men.

In view of these challenges, a number of policy considerations emerge. One such consideration is the need to establish an enabling policy and institutional environment to support the flow of innovative and equitable finance for implementation of an ambitious sustainable development agenda. A second consideration is the need for well-thought-out macroprudential measures to manage capital volatility, thus supporting economic stability and providing a resilient platform for inclusive growth. The imperative for commodity-dependent economies to diversify their economies into other sectors is the third area that is investigated. Fourth, some innovative actions that could be taken by economies in the region to better address climate change, particularly topical in the run-up to the United Nations Conference on Climate Change in Paris, are also discussed.

The thematic chapter of the *Survey* for 2015 examines how inclusive growth has been in the Asia-Pacific region. In doing so, it recognizes that inclusiveness is a multidimensional concept that spans economic, social and environmental dimensions of development. The analysis finds that growth has been more inclusive at the country level. Yet, large divergences of inclusiveness exist within countries between sexes and across the rural and urban sectors. It is of particular concern that income inequalities are large and widening in many countries, with wealthier people being able to secure access to better education and better health services, thereby increasing their employment prospects. If these inequalities are not addressed, intergenerational inequities have the potential to be perpetuated.

Making economic growth more inclusive requires strengthening the developmental role of the state. While Governments should create an enabling environment for the private sector to act as the main engine of growth, more efforts are needed to ensure equality of opportunities. There is a need for countries to make expenditure more development-oriented, particularly to ensure more equal access to education and health care and provide stronger social safety nets. Moreover, access to financial services needs to be broadened, particularly in rural sectors. Greater attention must be given to fostering the creation of employment, particularly by developing small and medium-sized enterprises and fostering rural industrialization.

I. Introduction

1. The year 2015 marks a watershed in global policymaking. It is the deadline for achieving the Millennium Development Goals, and it is expected that a set of sustainable development goals will be adopted in September to provide a framework for development policies beyond 2015. In view of these aspects, now is an opportune time to evaluate how successful the Asia-Pacific region has been in making economic growth more inclusive and sustainable. Therefore, the *Economic and Social Survey of Asia and the Pacific 2015* contains an examination of the economic growth performance in the region, highlighting the challenges that it is facing and with analyses of whether growth has benefited all people.

2. Real incomes per capita in developing economies of the region have doubled on average since the early 1990s. In countries such as Bhutan, Cambodia and Viet Nam, real income per capita has tripled, while in China it has grown more than sevenfold since 1990. Such impressive performances have lifted millions of people out of extreme poverty and has enabled the region as a whole to meet — ahead of the 2015 deadline — the first target under the Millennium Development Goals, namely, that of reducing by half the proportion of people whose income is less than $1.25 a day.

3. However, despite the region's success in achieving economic growth at high rates and significantly reducing poverty, economic growth is not as high as it could be or has been in the past. The region is expected to experience only a slight increase in its economic growth rate in 2015 and 2016. Reflecting this trend in economic growth and supported by lower international oil prices, inflation is forecast to decline further and remain low. More importantly, there is concern that not all have shared equally in the benefits of economic growth; that is, it has not been sufficiently inclusive. Inequality of income as well as of opportunity has risen between different geographies and sections of society, such as in rural and urban areas and among women and men.

4. Thus, a fundamental issue explored in the *Survey* for 2015 is that, while policy focus on economic growth is necessary, it is definitely not sufficient for achieving "development". Policymakers in the region will have to internalize the aspects of inclusive growth and sustainable development into their domestic policy frameworks in order to surmount the emerging challenges. It is a year in which countries ought to be gearing themselves up to adopt and adapt the proposed sustainable development goals.

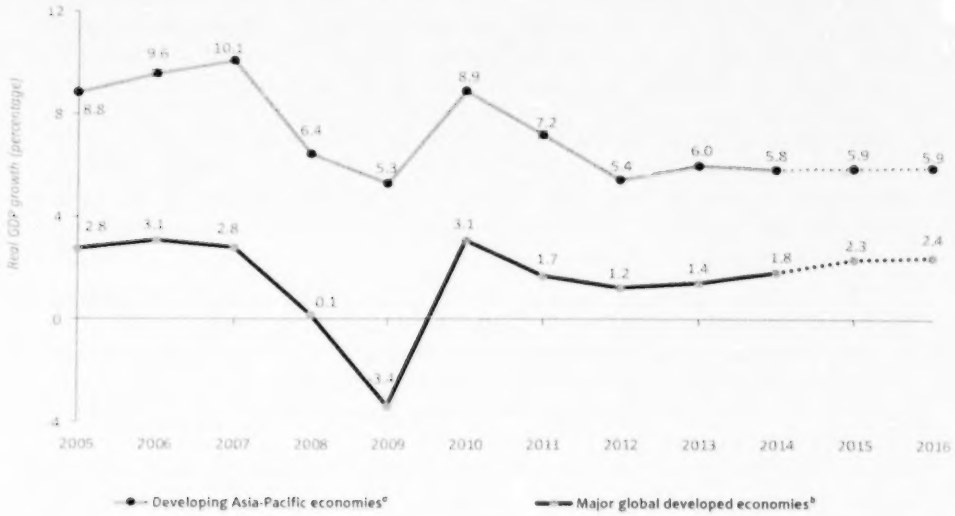
5. In the second section of the present summary of the *Survey*, there is an examination of the macroeconomic outlook and performance in the Asia-Pacific region. The section also contains analyses of some of the economic challenges faced in the region, as well as a discussion of some key policy options. To reflect the diversity of the Asia-Pacific region, the third section provides a more disaggregated analysis of economic issues and challenges being faced by each of the five subregions, thereby providing an opportunity to learn from a variety of experiences and policy considerations. Finally, the fourth section affords analyses in greater detail on the issue of just how inclusive growth has been in the region in recent decades.

II. Economic growth outlook and policy challenges

6. Economic growth in developing economies in the region is expected to increase slightly to 5.9 pc cent in 2015 from 5.8 per cent in 2014. This outlook is primarily associated more with domestic and intraregional factors than with external factors. Specifically, the role of private consumption and investment is expected to be much more pronounced in driving economic growth than exports, the prospects for which remain less upbeat. In the assessment of the Economic and Social Commission for Asia and the Pacific (ESCAP), the growth potential of the region's developing economies is being held back by structural weaknesses, such as infrastructure shortages and the excessive commodity-dependence of some economies. The fragile global economic recovery is just an additional constraint that is not helping growth prospects.

7. This outlook is based on expected positive trends in major developing economies, including Bangladesh, India, Indonesia, Papua New Guinea, the Republic of Korea and Thailand. Some of these economies are undertaking reform programmes under new administrations, which are expected to generate positive results in 2015. Despite only a moderate increase in economic growth in developing economies, excluding those in North and Central Asia, the region will continue to lead the global economic recovery, with growth in 2015 expected to be nearly two and one-half times greater than in the major global developed economies (see fig. I). Nevertheless, it is also the case that the growth differential between the region and the developed world is becoming smaller compared with the pre-crisis period, when growth in the region was more than three times faster. The narrowing differential is due to a slowdown in the region and to the fact that the developed economies have returned to growth that is close to their pre-crisis levels.

Figure I
Growth in developing Asia-Pacific economies and major global developed economies, 2005-2015



Sources: ESCAP, based on national sources and CEIC data. Available from www.ceicdata.com (accessed 30 March 2015); forecasts for major developed economies are based on the World Economic Outlook Database of the International Monetary Fund (IMF).

[a] Developing Asia-Pacific economies comprise 37 economies, excluding North and Central Asia. The series reflects the revised estimates of gross domestic product (GDP) growth for India from 2012 onwards. The revised estimates entail shifting of the base year from 2004-2005 to 2011-2012 and also deploying improved methodologies. Caution should be exercised in comparing growth rates between the earlier series and the revised series.

[b] Major developed economies comprise 36 economies, including Japan, the United States of America and the 19 countries belonging to the eurozone.

8. The outlook for inflation is better than that for economic growth. Inflation in the region is expected to decline noticeably to 3.4 per cent in 2015 from 3.9 per cent in 2014. This trend is driven primarily by lower international oil prices and reduced demand pressure in export-led economies. In addition to affecting inflation positively, the dramatic decline in international oil prices has allowed for significant reform in the area of fuel subsidies. This has released extrabudgetary resources, which can be effectively deployed to support infrastructure investment and inclusive growth measures. However, Governments are advised to remain focused on tax policy reforms to strengthen their public finances. This would be important for ensuring macroeconomic stability and for generating adequate resources for development spending.

9. Lower inflation has encouraged a string of interest rate reductions in many regional economies, which may support overall economic growth. However, one policy consideration is that considerable volatility in capital flows and exchange rates in the region can be expected, given the monetary-policy-related developments of major economies, such as Japan, eurozone countries and the United States of America. Such volatility may induce significant macroeconomic and financial instability in the region, risking not only the economic growth prospects for the

region, but also the sustainable development agenda by diverting the attention of policymakers to stability issues only. Therefore, the monetary-policy stance will need to be calibrated much more cautiously in going forward, especially in those economies that have weak fundamentals.

10. Merchandise trade in Asia-Pacific continues to face significant challenges as the year-on-year export and import growth across developing economies has remained weak throughout 2014. Risks to the prospects of trade in Asia and the Pacific in 2015 are mainly due to the slowdown of economic activity in China and the eurozone countries. Given the fact that these economies are major export destinations for most economies of Asia and the Pacific, with shares of 16 and 14 per cent of total exports, respectively, sluggish (import) demand in these economies remains a major risk to the export prospects of the region.

11. The poor trade performance in 2013-2014 occurred despite the apparent progress in the multilateral trade negotiations at the World Trade Organization level after the Bali Ministerial Conference of December 2013. Continued talks regarding two interregional trade deals involving Asia-Pacific economies, namely the proposed trans-Pacific partnership and the regional comprehensive economic partnership, did not help much to reinvigorate trade and investment flows. The proliferation of preferential trade agreements involving Asia-Pacific economies, which began in earnest in the early 1990s, is again under way after a temporary pause in 2012. There are several reasons behind the ongoing rise in preferential liberalization agreements; these include uncertainty about the conclusion of the Doha Round negotiations, continued weak import demand in developed-country markets, and the growing recognition of the benefits of South-South trade and economic cooperation.

12. The Asia and Pacific region has remained a favourable foreign direct investment (FDI) destination over the past few years. In fact, the share of the Asia-Pacific region in global FDI flows has been on the increase since 2005. Therefore, the Asia-Pacific region has demonstrated its resilience in the face of challenges in the global economic climate characterized by relatively low and volatile global FDI flows since 2007. Within Asia and the Pacific region, FDI inflows have varied greatly among different subregions and countries as a result of: (a) different FDI policies adopted by countries; (b) the impact of regional economic blocks; (c) macroeconomic uncertainties and structural constraints; and (d) geopolitical tensions.

13. In terms of structural reforms, some Governments are taking measures to strengthen their public finances, especially in the area of tax reform. Some countries are also moving to address land acquisition procedures, which have been one of the key barriers to private sector investment in many cases. Some Governments have also been engaged in the process of reducing the role of state-owned enterprises, as well as increasing foreign business participation. By doing so, they are attempting to reduce the fiscal burden of such enterprises, as well as increase their efficiency, and thereby increase their contribution to growth and employment.

14. To increase the supply potential of developing economies in the region, in which demand continues to remain substantial, owing to growing populations and incomes, the availability and quality of infrastructure will have to be improved. Furthermore, the region's significant role in global trade and global production networks means that improved infrastructure will also enable economies to better

service global demand. Improving infrastructure will also allow economic growth to be more inclusive by allowing the fruits of development to reach more persons, especially those in rural areas and the poorer sections of the society in urban areas.

15. In any case, increasing urbanization throughout the region is creating additional demands for infrastructure. Urbanization is expected to grow in line with rising wealth in the region, as higher-income economies typically have higher levels of urbanization. Some of the effects will be increased demand for utilities and for housing. There will also be a greater need for public transportation, in order to reduce the burden of congestion resulting from private vehicles. In meeting the diverse but related challenges posed by urbanization, it is logical for infrastructure deficits to be tackled in an integrated way that supports both sustainable and inclusive urban growth, but also ensures that the economic potential of the region's cities is realized.

16. While traditional sources of finance, such as tax receipts and overseas development assistance, may be important, they are inadequate to meet the infrastructure development requirements of the region. It will also be necessary to effectively develop regional capital markets and encourage public-private partnerships to bridge the wide financing gap. A supportive legal and regulatory environment, together with enhanced capacity to evaluate infrastructure projects, can go a long way in achieving this objective. The emergence of new development banks, for instance, the Asian Infrastructure Investment Bank, is also a welcome sign for infrastructure development in the region.

17. In terms of external challenges, expectations about monetary policy normalization by the United States of America have already led to a substantial increase in the dollar vis-à-vis currencies globally. Exchange rates in the region have also been affected by the strength of the dollar but there has been considerable divergence in performance between economies. A number of factors explain the relatively small depreciation in some currencies in the region. One is foreign exchange intervention by Governments, owing to concerns about imported inflation stemming from depreciation and to increased foreign debt repayment costs. Another reason for the relatively small decline in the value of currencies in some economies of the region is continuing institutional investor interest in financial assets, due to better growth prospects in comparative global terms.

18. Apart from the impact on exchange rates, capital outflows have the potential to undermine macroeconomic stability and household wealth by their impact on domestic asset markets. Some of the key asset markets in relatively open economies that had seen significant foreign capital inflows are the equity, bond and property markets. Outflows from these markets can destabilize the banking sector, as domestic banks may suffer losses on their investments in these markets, while they also negatively impact household wealth and therefore consumption because households will see declining values for their investments in these markets. Some economies have attempted to manage the scale of capital outflows from such markets by imposing or increasing macroprudential regulations in these areas.

19. Macroprudential policies offer an important complementary method of managing capital flows. They directly target the source of instability of capital flow volatility, namely, the domestic asset markets in which capital flows are invested. Such regulatory policies are aimed at reducing systemic risks, safeguarding the stability of the financial system as a whole against domestic and external shocks,

and ensuring that it continues to function effectively.[1] Rather than changing the cost of borrowing for the entire economy, macroprudential policies are targeted at controlling credit to what central bankers see as specific areas of financial excess.

20. Macroprudential policies can be grouped as follows: (a) caps on loan-to-value ratios, such as those in the housing sector; (b) limits on credit growth and other balance sheet restrictions, such as debt service limits on credit cards and personal loans; (c) explicit ceilings on banks' credit growth; and (d) capital and reserve requirements and surcharges, such as countercyclical capital requirements and higher reserve ratio requirements.[2] Typically, macroprudential policies differ from capital flow measures, which are meant to limit capital flows by non-residents. However, on occasion macroprudential policies may also include capital flow measures, such as in the case of policies to discourage foreign-currency borrowing. Macroprudential policies are normally enacted by central banks and are complementary to fiscal measures undertaken by Governments, such as increasing taxes and stamp duties on investors in certain sectors.

21. Commodity price swings are nothing new, but the recent sharp drop in the price of Brent crude oil has caught many economic managers in the region by surprise. Coal prices have also declined in recent quarters, affecting major exporters, such as Australia and Indonesia. Natural gas prices are also likely to fall, as they tend to track oil prices with some lag. Industrial metals, such as copper, iron ore and nickel, have also witnessed downward volatility, as is the case with food and agricultural raw materials, such as palm oil and rubber. While various demand and supply factors are at play, the recent decline in commodity prices may signal the end of a "commodity super cycle" after more than a decade of a commodity boom, which was only briefly interrupted by the global financial crisis.

22. Commodity-dependent economies, with different income levels and population sizes, are expected to feel negative impacts on multiple fronts, including output and employment, external and fiscal balance, and price and financial stability, largely via the exchange rate channel. In the longer term, commodity-dependence can affect the process of structural change in economies. Resource-rich economies tend to undergo less economic diversification, even as aggregate output and income rises.

23. Importantly, lack of diversification among commodity exporters is sometimes associated with weak governance and business environments. This is possible because of excessive rent-seeking activities. Human capital also tends to suffer, as primary sectors, such as mining, cannot absorb much labour compared with manufacturing. These deficits could hamper economic development, particularly the private sector. But it is also a concern because resources-driven economies would require a large public sector in order to distribute the wealth equitably across the population. But if there is much corruption and weak capacity in the Government, welfare gains will neither be widely nor efficiently realized.

24. There are several policy options that can be considered in tackling the challenges offered by the commodity-dependence of economies. For instance, instead of adopting fiscal rules for the overall budget deficit that are independent of

[1] Bank for International Settlements, "Group of Central Bank Governors and Heads of Supervision reinforces Basel Committee reform package", press release, 11 January 2010.

[2] Stijn Claessens, "An overview of macroprudential policy tools", IMF Working Paper WP/14/214 (IMF, 2014). Available at www.imf.org/external/pubs/ft/wp/2014/wp14214.pdf.

the business cycle, it is possible to target a structural or "cyclically adjusted balance", which can take into account the potential revenue shocks that are due to large movements in commodity prices.

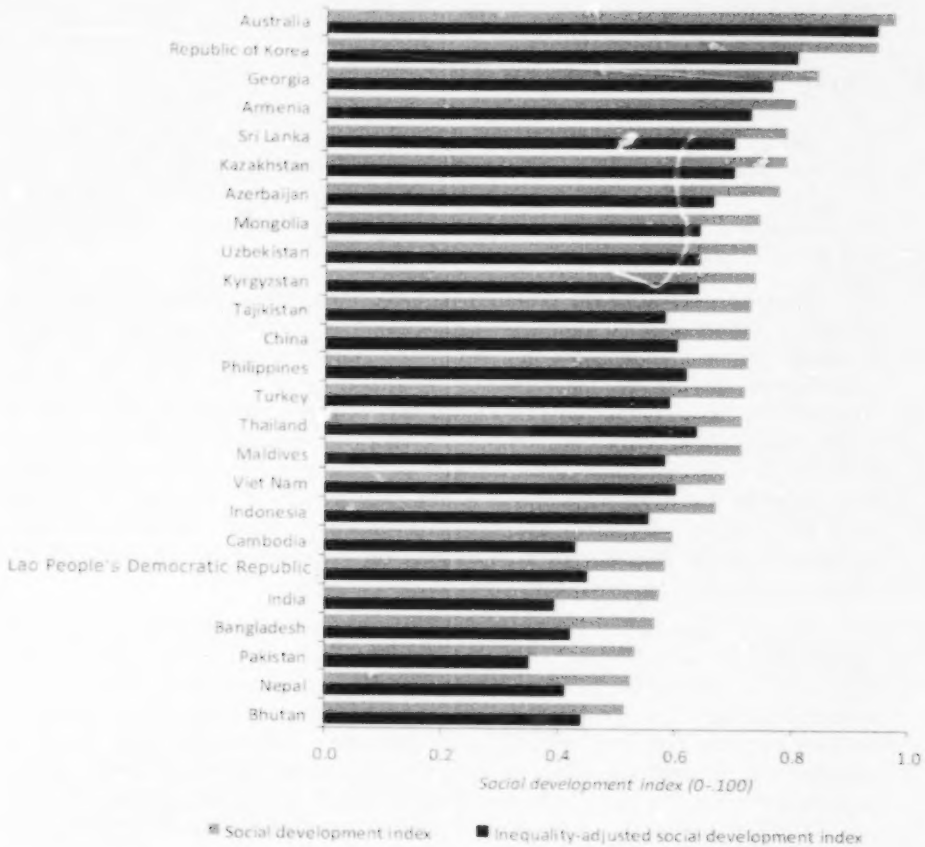
25. Similarly, an inflation target based on the consumer price index may not be appropriate for countries susceptible to bouts of trade shocks. Indices have been suggested that are more production oriented, rather than consumption oriented, so as to automatically accommodate fluctuations in the export price, while furnishing a nominal anchor for inflation expectations. The producer price index, for instance, could be modified to weight sectors not according to gross sales, but rather value added, as in the national income accounts.

26. Effective use of industrial and foreign direct investment policies for diversification from commodities is also possible. As part of industrial policy, the Government, the private sector and civil society could, in a participatory manner, come up with the required supportive policies, incentive structure and institutional arrangement to ensure flows of investment into the strategic sectors. For instance, they could target the promotion of new products and services that are higher value added and that allow for further diversification of the economy. Another way to facilitate strategic diversification is through attracting foreign investment while ensuring meaningful linkages and spillovers into the local economy and local enterprises.

27. Countries will also have to deal with significant challenges that are holding back the achievement of the inclusive aspects of growth, a subject which is explored in detail in section III. Income inequality (Gini index) has recently emerged as a significant concern for policymakers across the globe. One reason among many for this concern is the cost it imposes on achieving inclusive growth and development. ESCAP analysis indicates that high levels of inequality are undermining the economic and social achievements of the region. To estimate the negative impact, the analysis discounted levels of per capita income for 32 countries in the region with available data by a factor proportional to the extent of income inequality. The findings are that the GDP per capita declines substantially for many countries with relatively high Gini index levels (see fig. II). Furthermore, a social development index, when discounted for inequality, is also found to decline by up to 25 per cent for some countries.

28. Inequality of opportunity is also manifest in many components of social development where multiple forms of deprivation overlap and reinforce each other. A fundamental obstacle to inclusive growth is patriarchy. Inclusive growth cannot be achieved without addressing the discrimination, oppression and subjugation of women and girls, in both the public and private domains. In this respect, the exclusion of women from the economic realm and political governance needs to be addressed. Achieving inclusive growth must also be underpinned by provision of sufficient decent jobs. However, the region is still struggling to create adequate jobs in the formal sector and to improve overall job quality. In order to achieve inclusive growth, improving employment prospects for young people will be essential, as will addressing widespread vulnerable employment.

Figure II
Inequality-adjusted GDP per capita, 2012-2013



Sources: Based on data from the United Nations Development Programme (UNDP), *Human Development Report 2013*; ESCAP, *Statistical Yearbook for Asia and the Pacific 2014*; and the United Nations Statistical Division.

29. The environmental dimension of sustainable development is of particular importance to inclusive growth. The main areas of concern are addressing climate change and issues of sustainable energy. Climate change poses threats to sustainable development, as the adverse impacts of climate change can cut back decades of development gains. To turn the mitigation of the impact of climate change into opportunities, the policy instruments for mitigation should be aimed at generating co-benefits or double dividends, while paying attention to inclusiveness.

30. Energy security is also a pressing concern for regional sustainable development for a number of reasons. First, energy demand in the region has increased significantly. Second, many developing countries in the region are expected to continue to depend on imported fossil fuels and therefore be exposed to price volatility. Thirdly, the excessive energy-intensity of growth has resulted in numerous challenges, such as air pollution, threats to public health and harm to

economic competitiveness. Energy security can be leveraged by expanding energy access, developing renewable energy and improving energy efficiency — the three objectives of the United Nations Sustainable Energy for All initiative. Together with UNDP and the Asian Development Bank, ESCAP has formed a regional hub to implement that initiative.

III. Perspectives from subregions

31. The Asia-Pacific region is home not only to some of the richest and fastest-growing economies in terms of economic growth, but also to numerous poor and struggling economies with serious development challenges. A subregional perspective therefore provides an opportunity to learn from a variety of experiences and policy considerations.

32. Despite a revival in the economy of the United States of America, economic growth in export-oriented East and North-East Asia moderated in 2014, owing to subdued domestic demand. In China, the shift towards more sustainable, consumption-led growth has resulted in slower growth in fixed investment. Similarly, in Japan, output growth has stalled, with larger-than-expected quarterly contractions following the consumption tax hike in April 2014. Fiscal stimulus was launched in both China and Japan, as well as in the Republic of Korea, to combat tepid growth. In terms of outlook, economic growth is projected to increase modestly over 2015 and 2016, due to a slight pickup in Japan and stronger growth momentum in the Republic of Korea. With regard to China's economic growth, however, a slightly increased downward trend is expected.

33. An immediate policy challenge for East and North-East Asia is to cope with slowing demand from China. In this regard, efforts are being made to enhance trade connectivity, such as the Chinese-led initiative to set up the Asian Infrastructure Investment Bank. The Governments of countries in the subregion also introduced policies to boost domestic demand as an alternative source of growth, but their success will be constrained by the currently high debt levels and rapidly ageing population. Policies to address the multifaceted nature of an ageing population, such as job sharing and innovative financial products, are critical to overcoming medium-term challenges.

34. In the North and Central Asia subregion, the already sluggish economic growth in the Russian Federation in recent years was exacerbated by lower global oil prices and geopolitical tensions. As a result, the economy barely grew in 2014, while considerable contraction is expected during 2015 and 2016. Since the Russian Federation accounts for 80 per cent of economic output in North and Central Asia, subregional growth performance and prospects are also bleak. Already, subdued foreign exchange earnings resulting from declining commodity prices have led to the weakening of several of the subregion's currencies. Thus, unlike elsewhere in Asia and the Pacific, inflationary pressures are rising in North and Central Asia. This leaves the subregion in a low-growth, high-inflation situation.

35. Sources of economic growth in North and Central Asia are highly concentrated. In Azerbaijan, Kazakhstan, Turkmenistan and Uzbekistan, natural resources rent, defined as the difference between a commodity's price and its average production cost, amounts to between 37 and 47 per cent of GDP. In Armenia, Kyrgyzstan and Tajikistan, overseas workers' remittances account for

between 13 and 41 per cent of GDP. Policy reforms to diversify sources of economic growth would involve creating a dynamic, entrepreneurial private sector and strengthening the linkages between resource-based and non-resource-based sectors.

36. Pacific island developing economies grew at a three-year high rate in 2014. The expansion took place in nearly all those economies, but growth was driven mainly by mineral resource production in Papua New Guinea, which accounts for close to 60 per cent of the output of those economies. A devastating cyclone led to an economic contraction in the Solomon Islands in 2014, which highlights the subregion's vulnerability to frequent natural disasters. Catastrophes often disrupt economic growth and macroeconomic stability, given the small populations, limited land area and restricted room for macroeconomic policy response in those island economies. In terms of outlook, economic growth is projected to increase further, benefiting from strong mineral exports in Papua New Guinea, continued post-cyclone reconstruction activity in some countries and expected increases in tourism and remittance receipts.

37. Faster output growth is needed to generate more jobs in Pacific island developing economies where many people remain unemployed or still engage in subsistence activities. Limited infrastructure networks and human and institutional capacity have resulted in the subregion's low and uneven economic growth record. A more vibrant business sector would expand the economic base, reduce youth unemployment and support government revenue that could be spent to reduce notable gaps in service delivery in rural areas and outer islands.

38. Economic growth in South and South-West Asia in 2014 edged up but remained far below the subregion's impressive performance prior to the 2008 global crisis. The uptick was led mainly by stronger macroeconomic performance in India, which accounts for slightly more than half the output in the subregion. Economic growth also strengthened in Bhutan, Nepal, Pakistan and Sri Lanka, and was stable at rather high levels in Bangladesh and Maldives. The outlook for 2015 and 2016 is optimistic. Continued domestic reform efforts would help to unleash high potential growth that the subregion gains from a young population and abundant farm workers who can move to higher value-added manufacturing activity.

39. Three interconnected macroeconomic imbalances, namely, large fiscal deficits, sizeable current account shortfalls and high inflation, have retarded faster economic growth in South and South-West Asia. Tax reforms would help lower public borrowings, which have added inflationary pressure to the economies and contributed to wide saving-investment gaps. In addition to macroeconomic imbalances, severe power shortages are a key growth constraint. A broad-based policy effort is needed to tackle the energy crisis, for example, expanding the fiscal space, setting up an appropriate framework for public-private partnerships and enhancing corporate governance in public enterprises.

40. In South-East Asia, economic growth momentum softened in 2014 amid monetary tightening and weak commodity exports in Indonesia, political unrest in Thailand and cooling of the real estate sector in Singapore. Growth also slowed, albeit from a high base, in subregional economies with lower income levels, such as Cambodia, the Lao People's Democratic Republic and Myanmar. The near-term outlook is projected to improve, mainly underpinned by an economic recovery in Thailand and more rapid growth in Indonesia and the Philippines.

41. An increasing role has been observed in South-East Asia with regard to private consumption in supporting economic growth. While this helps to raise the subregion's resilience vis-à-vis external demand shocks, such consumer spending is financed largely by capital inflows. Regarding medium-term challenges, two key growth constraints are shortages of public infrastructure and skilled labour. With regard to infrastructure, the subregion needs to mobilize part of its available savings to reverse the declining trend in public infrastructure outlays. With regard to workers' skills, secondary enrolment should be actively encouraged and the quality of education and vocational training should match the needs of job markets.

IV. Inclusiveness and growth

42. Understanding the economic growth dynamics and prospects of the Asia-Pacific region, together with recognizing its achievements in terms of higher growth and poverty reduction, remains an important endeavour. However, development and overall human welfare is a multidimensional concept that involves more than just increasing the levels of income and reducing the levels of poverty. As highlighted in the first *Human Development Report*, "the purpose of development is to offer people more options. One of their options is access to income ... but there are other options as well, including long life, knowledge, political freedom, personal security, community participation and guaranteed human rights".[3]

43. Inclusiveness is thus also a multidimensional concept. Yet, while the term "inclusive growth" has been widely used by Governments, international organizations and other stakeholders in recent years, there is still a lack of consensus on a clear understanding of the concept. Keeping in view the broad social objective of human well-being, the inclusiveness definition should encompass the dimensions of economic inclusiveness, social inclusiveness and environmental inclusiveness. This captures the essence that representatives of Member States agreed upon in the outcome document of the United Nations Conference on Sustainable Development, which was held in Rio de Janeiro in June 2012. In that document, entitled "The future we want", they clearly stated their commitment to ensure the promotion of an economically, socially and environmentally sustainable future for the planet.

44. Therefore, the term inclusiveness is understood and defined in the present document as comprising the following: (a) increasing the average standard of living of the population (captured here by average real income per capita); (b) reducing income inequality; (c) reducing levels of extreme poverty; and (d) expanding and broadening equality in opportunities, such as access to public goods, including health and education services. Achievement of these objectives should lead to an increase in people's well-being — the ultimate objective of any society — in an inclusive manner.

Economic inclusiveness

45. Economic growth should be broad-based and inclusive, enabling all segments of the population to benefit from such growth, while incorporating the needs of the

[3] United Nations Development Programme, *Human Development Report 1990: Concept and Measurement of Human Development* (New York, 1990).

extreme poor and vulnerable. The elimination of extreme poverty must be one of the primary social objectives of all Governments, without which inclusive growth cannot be realized. While rates of extreme poverty have declined by half or more in most economies in the region, with the incidence of extreme poverty falling from 51 per cent of the region's population in 1990 to about 18 per cent of the population in 2011, poverty measured at the $2 line is still very high. In India and Nepal, more than 60 per cent of the population was living below this line in 2010. Moreover, there are large divergences in poverty rates within countries, usually across genders, but also between rural and urban areas.

46. Despite the success achieved in reducing extreme poverty, increases in levels of real income have not always been distributed evenly within countries. On the contrary, income inequality has increased in many countries in the region, especially in the major developing countries. Since the 1990s, the population-weighted mean Gini coefficient for the entire region rose from 33.5 to 37.5. In some countries, particularly in the region's larger economies, namely China, India and Indonesia, the Gini coefficient increased considerably. Similarly, in many countries, including the region's more populous economies of Bangladesh, China, India and Indonesia, the richest quintile (20 per cent of the population) has been able to increase its share in national income, while that of the lowest quintile has declined.

47. Overall, while there is no strong evidence in the economic literature that growth affects income inequality, or that income inequality affects growth, it has been generally concluded that high initial inequality is associated with lower later growth. Moreover, high inequality can contribute to greater social, economic and political instability, as when incomes are distributed more unevenly, the ruling classes may expend more effort on protecting their wealth and strengthening rent-seeking activities than on generating inclusive patterns of growth, thereby undermining the quality of governance.

48. One reason for the uneven progress that has taken place within countries is the fact that economic growth has not necessarily resulted in commensurate employment. Indeed, in many developing countries the lack of productive employment is one of the major reasons for a high incidence of poverty.

Social inclusiveness

49. With inequalities emerging in many other components of development, "inequality in income" must be distinguished from "inequality of opportunity", which refers to inequalities resulting from circumstances that are beyond an individual's control. Thus, while outcomes such as "earnings", or "income" can be determined by factors for which a person can be responsible (such as the amount of effort exerted in a job), they are also affected by factors that are beyond a person's control and that are often dependent on family circumstances. Two critical factors in identifying whether growth has been inclusive are the availability of education and health services.

50. Overall, the region has made significant progress in improving access to primary education. However, the picture is different for secondary education and even more so for tertiary education. In many countries, less than half of all children of secondary school age are enrolled in school. Moreover, girls' secondary enrolment often lags behind that of boys, especially in rural areas, although the gap shrinks in higher income quintiles. Indeed, generally, higher income groups receive

more years of schooling than lower income ones. In most countries there are also significant differences in the quality of education received, with the lower income groups mainly attending poorly maintained over-crowded public schools, and the children of the wealthier attending well-funded private schools. Over time, this aggravates intergenerational inequality.

51. Access to health services is a further critical element in identifying whether growth has been inclusive. Better health, for instance, contributes to growth by improving the motivation and productivity of workers. In addition, better health may result in a decline in the dropout rate among schoolchildren and thus reinforce the positive impact of education on growth and equity, especially intergenerational inequality. Access to health services is defined by accessibility, which is largely related to geographic location, affordability, that is, whether people can afford the services that are available, and acceptability, which relates to whether people are willing to use services when they are available and possibly affordable.

52. While most countries in the Asia-Pacific region have made efforts to broaden access to public health care, there are still spatial differences. For example, in a large number of countries in the region, provision is concentrated in urban areas. Moreover, many public health centres do not have qualified and experienced health professionals, with the result that the service provided is often of poor quality. Furthermore, in several countries, most health-care expenditure is borne by private households, which can make health-care services barely affordable to many households, particularly in the lower income quintiles. This is in contrast to countries, including Kiribati and Thailand, that have achieved almost universal health-care services through public service provision or through universal public health insurance. Finally, people may refrain from using health-care services even though they are available and affordable. In some cases this may be due to the perceived lack of good-quality care. In other instances, the services may not be considered socially or culturally appropriate, which is particularly the case when it comes to sexual and reproductive health services.

Inclusive development and the environment

53. There is general agreement that economic growth tends to negatively affect environmental quality. While degradation of the environment has adverse impacts on everyone, the poor are particularly affected, as they are less resilient to the negative impacts of environmental degradation. At the same time, inequality and poverty contribute to environmental degradation, because in less developed countries, and for the poor in general, there is less focus on the complex issues of the environment and how it affects their economic future. Environmental degradation can therefore also be the outcome of economic inequality. Thus, when moving up the development ladder, efforts must be made to safeguard the environment and to increase the access of persons to such basic infrastructures as electricity, clean drinking water and sanitation.

54. The region has made important progress in increasing access to improved water sources since 1990, with the percentage of persons without access to improved water sources dropping from around 27 to about 8 per cent today. Yet, large disparities still exist between rural and urban areas. At the same time, access to improved sanitation has improved more moderately, with only about 59 per cent of the Asia-Pacific population having access to these facilities in 2011, compared

with around 36 per cent in 1990. South and South-West Asia remains the region with the lowest level of access to improved sanitation, with 798 million people lacking access to these facilities. In some countries this may be linked to increasing urbanization pressures, as the number of people living in slums in urban areas has increased significantly.

55. With its economic expansion, the greenhouse gas emissions of the region have increased considerably, owing mainly to the combustion of fossil fuels for electricity generation, transport and industrial uses. Although the carbon dioxide intensity of output has been decreasing, it remains quite high and was approximately 50 per cent higher than the global average intensity in 2010. Responding to increasing demands for energy, electricity production has increased significantly since 1990. However, compared with urban populations, rural populations in many countries still do not have access to basic energy services, with at least 620 million people lacking access to electricity and almost 1.9 billion people relying on biomass for cooking. While renewable sources of energy are becoming increasingly important, fossil fuels remain major energy products in the production process.

Economic and Social Commission for Asia and the Pacific index of inclusiveness

56. The multidimensional character of inclusiveness and the diverging trend of economic, social and environmental indicators clouds any judgement call as to whether growth has been inclusive in the region. For example, while a country may have made significant advances in terms of social development, its success in accelerating poverty reduction or reducing income inequality may be less obvious. Even within each category of the three dimensions of development, it may not be clear whether growth has been inclusive.

57. To address this more methodologically and to reflect the definition of sustainable development that representatives of Member States agreed upon in the outcome document of the United Nations Conference on Sustainable Development, ESCAP has created a composite index of inclusiveness, comprising three sub-indices that measure how inclusive growth has been in economic, social and environmental terms. Each of these sub-indices captures five relevant indicators and computes a score for the periods 1990-1999 and 2000-2012.

58. The table below shows the score and rank of countries for overall inclusiveness for the 16 countries in the region with available data. Among these, economic growth has been the most inclusive in Kazakhstan, the Russian Federation and Thailand and the least inclusive in Bangladesh, India, Nepal and Pakistan. Although economic growth has been more inclusive in recent years in the Asia-Pacific region, some countries have made more progress than others. Thus, a rapid increase in scores of China, the Islamic Republic of Iran and Sri Lanka contributed to the decline in rank of Tajikistan. More inclusive growth in China and the Islamic Republic of Iran also led to a decline in rank of the Philippines.

Table
Scores and ranking of countries for inclusiveness of growth, 1990-1999 and 2000-2012

	Inclusiveness			
	Score		*Rank*	
Countries	*1990-1999*	*2000-2012*	*1990-1999*	*2000-2012*
Bangladesh	0.54	0.60	12	12
Cambodia	0.51	0.56	14	15
China	0.65	0.73	10	7
India	0.53	0.60	13	14
Indonesia	0.58	0.68	11	11
Iran (Islamic Republic of)	0.66	0.73	8	6
Kazakhstan	0.80	0.82	1	1
Malaysia	0.72	0.78	4	4
Nepal	0.48	0.60	15	13
Pakistan	0.46	0.55	16	16
Philippines	0.66	0.70	7	10
Russian Federation	0.77	0.80	2	2
Sri Lanka	0.71	0.77	6	5
Tajikistan	0.72	0.73	5	8
Thailand	0.73	0.79	3	3
Turkey	0.65	0.72	9	9

Source: ESCAP calculations.
Note: The indicators of the index have been normalized linearly and scaled from zero to one, so that a higher score represents an improvement in the indicator/index.

59. Moreover, while economic growth has been inclusive at the country-wide level, large divergences exist within countries between genders, across the rural and urban sector and between regions. Of particular concern is the fact that income inequalities are large and widening in many countries. With the wealthier being able to secure access to better education and better health services, and thereby increasing their employment prospects, intergenerational inequities have the potential to be perpetuated unless inequalities in income are addressed.

60. Several explanations for the widening of income inequalities have been put forward. These include market-oriented reforms that countries have embraced as they integrated more closely with the global economy, as these have affected income distributions within countries. In addition, in many countries, real wage growth has lagged behind productivity growth, thereby contributing to a declining share of labour income in output and a widening of income inequality, owing to the more unequal distribution of capital.

61. While the private sector plays a critical role, making economic growth more inclusive requires strengthening the role of the state in development. The main role of the Government is to ensure that equality of opportunities exists. This includes broadening access to education and health services and strengthening social safety

nets. Governments should also create an enabling environment for the private sector to act as the main engine of growth, comprising strong legal and regulatory frameworks, better coordination and accountability of institutions, and macroeconomic and financial stability through prudent policies.

62. In many countries, greater attention must be given to the development of small and medium-sized enterprises, particularly in the rural sector. Thus, despite the importance of agriculture in terms of providing livelihoods for large proportions of the population, in most developing countries in the region, industry and the services sector were the primary drivers of economic growth, leading to a significant decline in the contribution of agriculture to the region's GDP. Addressing the neglect of agriculture is therefore crucial in reducing poverty and inequality. Options include diversifying into high-value crops, focusing on quality and standards, and investing in research, and development and human capital to increase agricultural productivity.

63. Policies should also emphasize development of the non-farm rural sector by fostering rural industrialization through small-scale industries. This would strengthen linkages between agriculture and non-agriculture sectors, producing both backward-forward and production-consumption linkages within agriculture and between agriculture and non-agriculture sectors. Agricultural productivity growth and consumption linkages generated by increased rural incomes would stimulate the rural economy further. For instance, the income generated by the ready-made garments sector in Bangladesh has created significant spillovers on demand for non-tradable goods and services, which has created a positive impact on poverty dynamics in urban and rural areas and on the development and diversification of small and medium-sized enterprises through backward and forward linkages. Importantly, to reduce the risk of being trapped in a low wage, low productivity but labour-intensive development stage, countries need to strengthen the link between wages and productivity through appropriate wage and labour market policies.

64. Fostering rural development and rural industrialization also requires an inclusive financial system that offers access to financial products and services for the poor, particularly as a significant share of the population, especially the poor and those in the rural sector, remain excluded from accessing financial services. Here, monetary policy can play an important role in fostering more inclusive growth, given its ability to affect the price and volume of credit, and in supporting a framework that encourages the development of a vibrant banking sector that caters to those currently marginalized.

65. Policymakers can also make growth more inclusive by targeting public expenditure to expand equality in opportunities. Indeed, econometric analysis shows that when Governments increase total public expenditure, social inclusiveness, as captured by the index, increases. Such expenditure includes spending on such areas as health, education and social safety nets. It also includes attempts to make existing expenditure more efficient, more effective and more development-oriented. In some countries, such as Sri Lanka, growing inequality is explained mainly by the growing disparity in households' access to education and infrastructure. An important dimension may also be to focus policy on regional economic development — paying special attention to helping the most deserving and vulnerable groups in each region — in order to bridge regional disparities.

66. Governments need to increase the quality of the labour force in order to increase the employability and productivity of workers and to address the issue of inequality of opportunities. One way to do so is to expand investment in education. Another is to increase access to and affordability of health systems. Indeed, public expenditure on health and education has a beneficial impact on social inclusiveness that is more than twice that of total public expenditure. However, no developing Asia-Pacific economy currently allocates 5 per cent of GDP or more as public expenditure on health, as recommended by the Sustainable Development Solutions Network. In many economies, public expenditure does not even reach 1.5 per cent of GDP, including in some of the larger economies of the region, such as Bangladesh, India, Indonesia and Pakistan.

67. One reason for expenditure on health, education and social security being relatively low in many economies in the Asia-Pacific region is that existing expenditure is often not sufficiently development-oriented. For instance, in many economies, significant spending is devoted to defence; in several countries, such expenditure exceeds that on health and education combined. Similarly, significant resources are devoted to subsidies, especially related to energy. While curbing increasing levels of non-development expenditure and removing or reducing harmful subsidies is politically challenging, low oil prices have enabled several countries to move forward in reducing regressive subsidies and boost expenditures on education, health and social protection. These policy measures will further support their efforts at fiscal consolidation and to release additional financial resources for inclusive growth. Reducing non-development expenditure would further free important resources to strengthen social expenditure and to address the large gaps in infrastructure that are impeding development of the region, in particular those of the rural sector.

68. A further limiting factor to making public spending more effective in the region is the fact that tax revenues are quite low in many countries. Using the ESCAP index of inclusiveness, and its subindices, one can see that raising levels of revenue (as a percentage of output) has not had a significant impact on economic inclusiveness in the region, which suggests that tax policy has not been successful in redistributing income there. Yet, higher levels of revenue have increased social inclusiveness, highlighting the importance of revenue for financing development-oriented expenditure to broaden equality in opportunities in the region.

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Situation and outlook for Latin America and the Caribbean 2014-2015

Note by the Secretary-General

The Secretary-General has the honour to transmit herewith a report on the situation and outlook for Latin America and the Caribbean for the period 2014-2015.

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Situation and outlook for Latin America and the Caribbean 2014-2015

[Original: Spanish]

Summary

In 2014 the Latin American and Caribbean economy continued the slowdown that began after the upturn of 2011, when the region emerged from the aftermath of the global financial crisis. At a modest 1.1 per cent, the region's 2014 growth rate represented a virtual standstill in per capita gross domestic product (GDP). As well as specific aspects of economic performance in each country, this regional rendering reflected the slack global growth and its differentiated impacts on the economies.

Falling prices for the region's principal export commodities worsened the terms of trade and kept the current account deficit at 2.7 per cent of regional GDP, despite the contraction of imports.

Domestic demand was not strong enough to offset weak external demand. The contribution of consumption to growth fell sharply, and gross fixed capital formation contracted at the regional level, albeit with large differences from one country to another.

The insipid economic growth weakened job creation, especially wage employment. Nevertheless, thanks to a heavy decline in the participation rate, the drop in the employment rate did not push up unemployment, which came down again, although only slightly, from 6.2 per cent a 6.0 per cent. With unemployment low and inflation stable, real wages rose moderately in most of the countries.

Fiscal policy efforts were geared towards expansionary measures to contain the slowdown, which contributed to a wider deficit — 2.7 per cent of GDP in 2014 compared with 2.4 per cent in 2013 — although again with significant differences among countries. On the monetary and exchange-rate front, countries in the region adopted a clearly countercyclical approach in 2014, regardless of policy regime. More emphasis was placed on stimulating aggregate demand and setting and monitoring medium-term inflation targets.

The region continues to post modest economic growth in 2015, with a projected rate of 1.0 per cent. There are sharp differences between the subregions in this regard; however, projections are 4.0 per cent for Central America, 3.0 per cent for Mexico, 1.9 per cent for the English- and Dutch-speaking Caribbean and 0.0 per cent for South America.

I. Introduction

1. In 2014 the Latin American and Caribbean economy continued the slowdown that began after the upturn of 2011, when the region emerged from the aftermath of the global financial crisis. At 1.1 per cent the region's 2014 growth rate represented a virtual standstill in per capita GDP). As well as specific aspects of economic performance in each country, this regional rendering reflected the slack global growth and its differentiated impacts on the economies.

2. Falling prices for the region's principal export commodities worsened the terms of trade and kept the current account deficit at 2.7 per cent of regional GDP, despite the contraction of imports.

3. Domestic demand was not strong enough to offset weak external demand. The contribution of consumption to growth fell sharply, and gross fixed capital formation contracted, although with large differences from one country to another.

4. The insipid economic growth weakened job creation, especially wage employment. Nevertheless, thanks to a heavy decline in the participation rate reflecting the procyclical behaviour of the region's labour supply, the drop in the employment rate did not push up unemployment, which edged down again. With unemployment low and inflation stable, real wages rose moderately in most of the countries.

5. Fiscal policy efforts were geared towards expansionary measures to contain the slowdown, which contributed to a wider deficit — 2.7 per cent of GDP in 2014 compared with 2.4 per cent in 2013 — although again with significant differences among countries. In Latin America public debt remained contained at about 32 per cent of GDP. Some of the Caribbean countries still have high debt burdens, however, with an average of 80 per cent of GDP for the subregion, including a significant external component.

6. On the monetary and exchange-rate front, countries in the region adopted a clearly countercyclical approach in 2014, regardless of policy regime. More emphasis was placed on stimulating aggregate demand and setting and monitoring medium-term inflation targets. At the same time, authorities sought to mitigate the effects of external volatility on the region's financial markets by using international reserves and making changes to macroprudential regulations.

7. The region has continued to post modest economic growth in 2015, with a projected rate of 1.0 per cent. There are sharp differences between the subregions in this regard: projections are 4.0 per cent for Central America, 3.0 per cent for Mexico, 1.9 per cent for the English- and Dutch-speaking Caribbean and 0.0 per cent for South America.

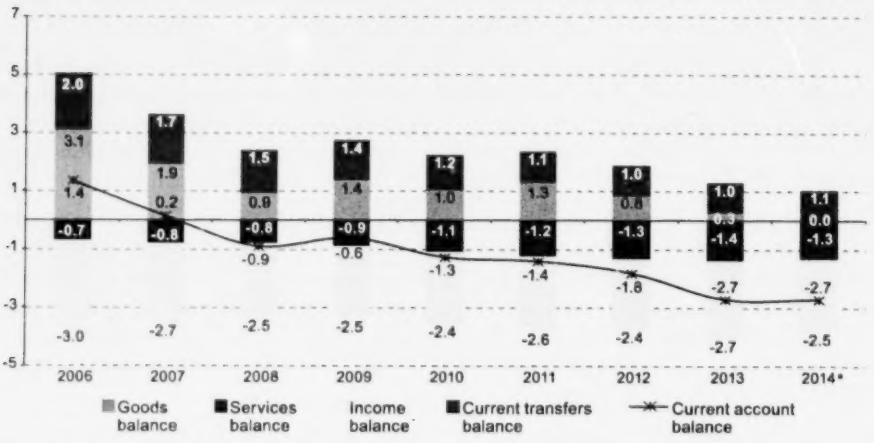
II. The external context and its impact on Latin America and the Caribbean

8. Global growth picked up slightly in 2014 to 2.6 per cent (compared with 2.5 per cent in 2013), leading to an equally weak increase in world trade with respect to the previous year. However, the various country groupings showed very different performances and the stronger growth of the developed countries (the end of the contraction in the eurozone and stronger growth in the United States), was almost completely offset by the slower growth in the transition and developing economies.

9. The international financial markets continued to show relatively high liquidity and limited risk perception. These markets' interest rates remained low, with no surge ensuing after the withdrawal of monetary stimulus in the United States, although financial flows did show some volatility in 2014. The European Central Bank embarked upon a programme of quantitative easing, which was expanded in 2015.

10. Global conditions affected the performance of the external sector in Latin America and the Caribbean in various ways, and the region's current account deficit remained at the same level as in 2013 (2.7 per cent), breaking a four-year run of widening deficits (see figure I).

Figure I
Latin America: current account structure, 2006-2014
(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures.
[a] Preliminary data.

11. In a context of slow growth in the regional economy and in global trade, the goods trade balance worsened as a proportion of GDP (from 0.3 per cent in 2013 to 0.0% in 2014), since imports fell less than exports.

12. The drop in export values was attributable chiefly to a fresh downtrend in prices for raw materials, especially in the second half-year, although unevenly from one country to another. Average prices for the region's basket of raw materials were down by 24.4 per cent year-on-year in December 2014, following a drop of 2.7 per cent in 2013. Metals prices were down by 21.9 per cent year-on-year in December 2014, compared with 8.9 per cent in 2013. Prices for foods, tropical beverages and oils and oilseeds fell by 7.4 per cent, versus a drop of 5.6 per cent in 2013. Lastly, the price of energy, after showing a rise of 3.2 per cent in December 2013, plunged 37.3 per cent in 2014. In particular, oil prices slumped heavily in the second half, with a drop of 44.1 per cent between June and December 2014. On average for the year, the oil price was down by 6.4 per cent compared with 2013, owing mainly to the weakness of demand in the European Union and China, in a context of stable global supply.

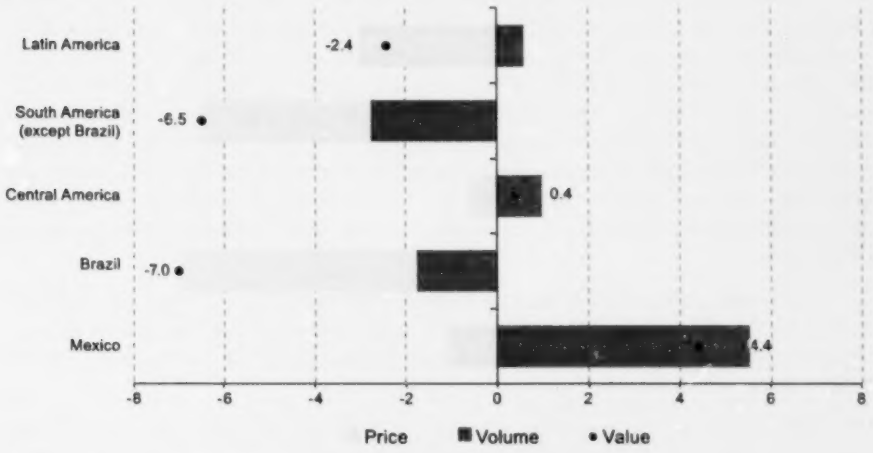
13. Consequently, sluggish external demand and rising commodity supply in some markets (oil and gas, soybeans and copper) also caused a drop in external prices (unit export values fell by 3.0 per cent), which countered the region's export effort and pulled down export values (-2.4 per cent) more heavily than in 2013 (-0.3 per cent).

14. As figure II shows, South America sustained a drop in export prices and volumes, whereas in Mexico export volumes rose but unit prices fell.

Figure II

Latin America: estimated variation in export values, by volume and price, 2014

(Percentages)



Source: ECLAC, on the basis of official figures.

15. Mexico, Central America and the Caribbean services-exporters benefited from steady economic recovery in the United States, the main export destination for several of these countries.

16. Imports, too, showed a differentiated pattern by subregion. In most South American countries, the sharp slowdown in domestic demand led to heavy falls in import volumes (-4.1 per cent). By contrast, import volumes continued to climb in Colombia, Mexico and most of the Central American countries. The overall result was that import values for Latin America as a whole contracted for the first time since 2009, by 1.0 per cent.

17. The differentiated developments regarding external trade prices led to a 2.3 per cent terms-of-trade loss for the region overall, but with a mixed performance across the region. In South America and Mexico the downturn (of 2.7 per cent and 1.8 per cent, respectively) was the result of falling prices for export commodities.

18. The terms of trade for the Central American countries, Haiti and the Dominican Republic climbed by 1.4 per cent, thanks to rising prices for some of the subregion's export products and to falling prices for energy imports. Terms of trade for the Caribbean food- and fuel-importing economies (not including Trinidad and Tobago) rose by 2.0 per cent.

19. Tourism in the region picked up somewhat, especially in Mexico and Central America, which helped to narrow the deficit on the services trade balance (from 1.4 per cent in 2013 in 1.3 per cent of GDP in 2014). International tourist arrivals in Mexico actually rose by a hefty 19.3 per cent in the first 11 months of 2014. The tourism sector grew faster in Mexico than in any other country in the region, thanks to economic recovery and increasing consumer confidence in the United States. Tourist arrivals were also up in the Caribbean (by 6.6 per cent) and in the Central American countries (5.7 per cent), for the same reason. In the case of South America, the football world cup contributed to a rise in tourist arrivals (5.7 per cent).

20. Although higher flows of family remittances from the United States were partially offset by smaller remittances coming from Spain, the overall result was an improvement in the transfer balance, which edged up to 1.1 per cent of GDP in 2014, from 1.0 per cent in 2013. Specifically, the upturn in the United States labour market led to a strong gain in remittances to Mexico (up 8 per cent in 2014) and to Central America and the Dominican Republic (9.9 per cent in both cases). Because of the persistently poor economic situation in Spain, remittance flows into the South American countries which receive most of their remittances from that country (Bolivia (Plurinational State of), Colombia, Ecuador and Paraguay) fell by a heavy 4.8 per cent.

12. Lastly, the deficit on the income balance narrowed (from 2.7 per cent of GDP in 2013 to 2.5 per cent in 2014) thanks to smaller remittances of profits on foreign direct investment (FDI), as a result of the lower prices for the region's export commodities during the year.

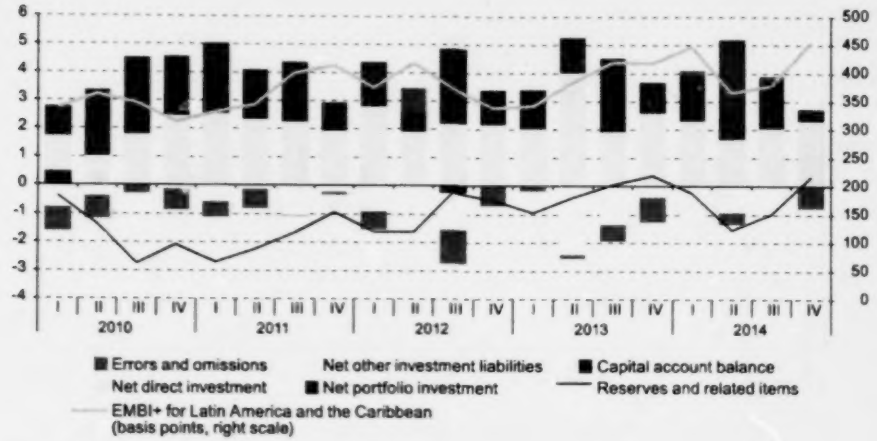
22. With regard to the financial account, in 2014 the region in general retained ready access external financing. The net flow of financial resources into the region was more than enough to cover the balance-of-payments current account deficit, and the stock of international reserves of the region overall expanded by about 3 per cent.

23. However, as shown in figure III, the current account behaved differently in the first and second halves of the year. In the second half, net flows of capital into the region declined and shifted in structure: FDI remained stable while portfolio investments fell sharply.

Figure III

Latin America (18 countries): components of the capital and financial account and the balance of payments and average sovereign risk, quarterly,[a] 2010-2014[b]

(Percentages of GDP and basis points)



Source: ECLAC, on the basis of official figures.

[a] According to the Emerging Markets Bond Index (EMBI+).

[b] The data for the final quarter of 2014 do not include the Bolivarian Republic of Venezuela owing to lack of information.

24. This decline in portfolio flows occurred in parallel with a relative increase in average sovereign risk in the countries of the region; the spread on the EMBI+ index for the region — which had narrowed in the second quarter of 2014 — widened again in the third and fourth quarters and closed the year at 508 basis points.

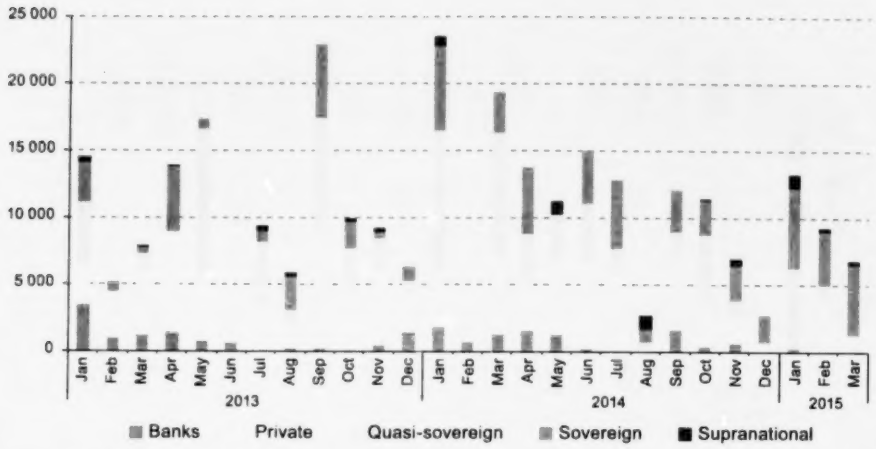
25. Sovereign spreads rose slightly (just 10 basis points on average) for almost all the countries in 2014. The exceptions were the Bolivarian Republic of Venezuela and Ecuador, which are both highly dependent on exports of hydrocarbons and therefore very exposed to the effects of the sudden steep fall in oil prices. For those two countries, sovereign risk expanded by 1,356 and 353 basis points, respectively, to reach 2,457 and 883 basis points at the end of 2014.

26. Bond issues in the external market reached a record figure of $ 133 billion in 2014. Issues increased significantly in the first half of the year, chiefly because of the steep rise in sovereign, quasi-sovereign and State bank issues. In this period, Brazil, Chile and Mexico were especially active in the external bond markets in a context of still-low interest rates.[1]

27. In the second half of 2014, however, issues dropped to just over half the level in the first half-year ($49 billion, compared with $84 billion in the first semester) (see figure IV).

[1] ECLAC, *Preliminary Overview of the Economies of Latin America and the Caribbean*, (United Nations publication, Sales No. E.15.II.G.2).

Figure IV
Latin America and the Caribbean: external bond issues by institutional sector, January 2013-March 2015
(Millions of dollars)



Source: ECLAC, on the basis of figures from the Latin Finance Bonds Database, JP Morgan and Merrill Lynch.

28. Much of this fall reflects the downturn in quasi-sovereign issues, especially in Brazil. The State oil company, Petrobras, which issued large amounts in January and March 2014, has not returned to the market since and shows no signs of doing so in the near future.

III. Economic growth, employment and wages

A. Economic activity

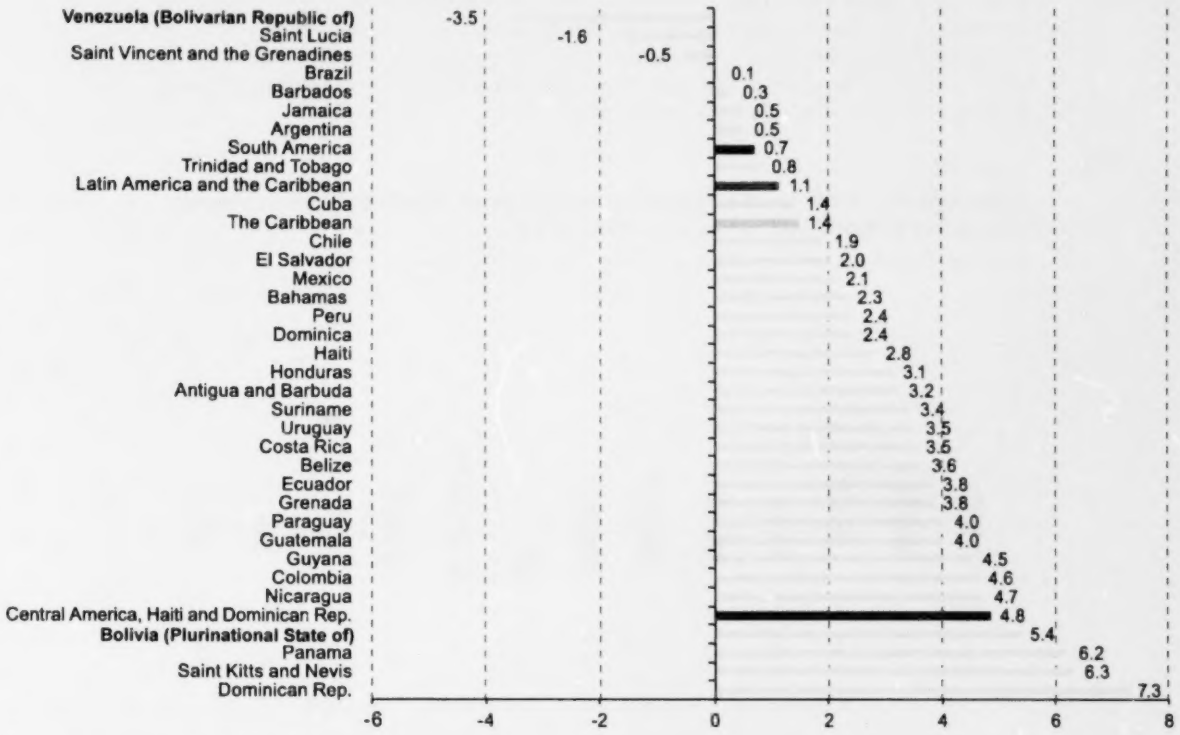
29. The GDP of the Latin American and Caribbean region grew by 1.1 per cent in 2014, which was the slowest rate of expansion since 2009 and translated into a standstill in regional per capita GDP. The sluggish regional performance was largely determined by slow or negative growth in some of the largest economies, especially Argentina, Brazil and Venezuela (Bolivarian Republic of). Nevertheless, there were substantial differences in growth rates from one country to another.

30. The region's fastest-growing economies were the Dominican Republic and Panama, followed by the Plurinational State of Bolivia, Nicaragua, Colombia and Guyana, then Guatemala and Paraguay. By subregion, South America posted economic expansion of 0.7 per cent (as against 2.8 per cent in 2013), while Central America expanded by 3.7 per cent (4.0 per cent in 2013). The Caribbean economies (not including Cuba, the Dominican Republic or Haiti) carried the 2013 growth rate of 1.4 per cent through to 2014, a stronger rate than in previous years and the highest since 2008 (see figure V).

Figure V

Latin America and the Caribbean: GDP growth rates, 2014[a]

(Percentages, on the basis of dollars at constant 2010 prices)



Source: ECLAC, on the basis of official figures.

[a] Preliminary figures.

31. The pattern of economic activity was differentiated in the region throughout 2014. The slowdown took firmer hold in the second quarter, as investment contracted in several South American economies and consumption weakened across the board. The third quarter brought the beginnings of an upturn in economic activity which carried over into the fourth quarter, but was not enough to offset the poor showing of the first three quarters or to regain the rate from early in the year.

32. The lacklustre regional growth may be attributed in large part to a slowdown in private consumption which, in turn, reflected weak job creation and slacker credit growth in the financial system. This was in addition to the contraction in gross fixed capital formation attendant on lower economic growth and, in some countries, the contraction of the construction sectors, as well as a fall across the board in investment in machinery and equipment.

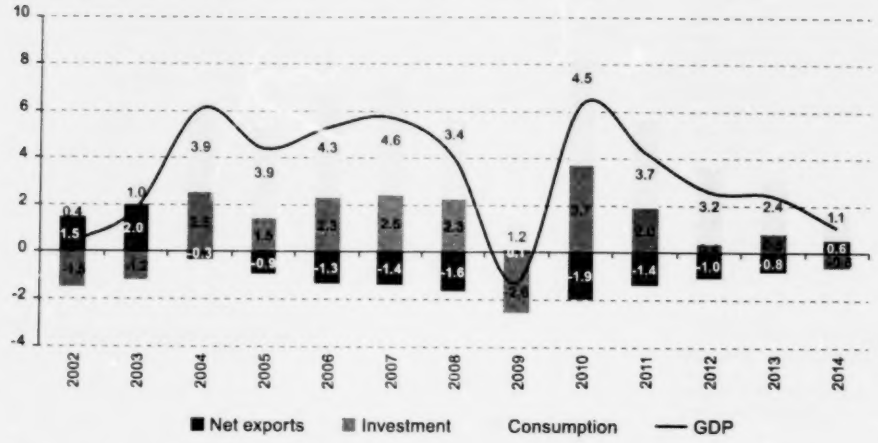
33. Gross fixed capital formation contracted by almost 1.5 per cent, which translated into a drop in the investment rate at the regional level. Measured as a percentage of GDP based on dollars at constant 2010 prices, the regional investment rate dropped to 19.7 per cent of GDP — below the 2010 figure (19.8 per cent) — having hovered at about 20.5 per cent between 2011 and 2013.

34. Net exports made a positive, although slight, contribution to regional growth, since exports of goods and services posted stronger growth (about 2.0 per cent), in real terms, than in 2013 (-0.6 per cent). The upturn in exports was strongest in Mexico and some Central American economies, which benefited from the economic upswing in the United States and a recovery in tourism, an important source of foreign exchange for these countries. Imports of goods and services stagnated in real terms, reflecting slower growth in private consumption and the contraction in gross fixed capital formation (see figure VI).

Figure VI

Latin America: GDP growth rate and contribution to growth by the components of domestic demand and net exports, 2002-2014[a]

(Percentages and percentage points, on the basis of US dollars at constant 2010 prices)



Source: ECLAC, on the basis of official figures.

[a] Preliminary figures for 2014.

B. Domestic prices

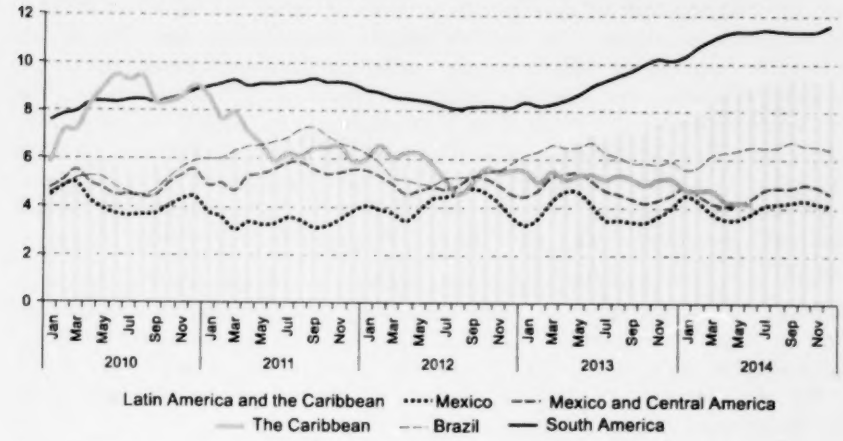
35. Cumulative 12-month inflation in the Latin American and Caribbean region was 9.2 per cent to October 2014, compared with 7.6 per cent % in December 2013. Inflation rose above the 2013 figure in most of the countries, but with significant differences between them. The regional figure is heavily influenced by the two-digit rise in inflation registered in Argentina and the Bolivarian Republic of Venezuela.

36. The rate of inflation was 8.3 per cent in the 12 months to December 2014 in Uruguay, and 9.0 per cent and 7.8 per cent, respectively, in the 12 months to September in Jamaica and Trinidad and Tobago. Consumer inflation was lowest in El Salvador (0.5 per cent), the Bahamas (0.2 per cent), Belize (0.7 per cent) and some economies of the Eastern Caribbean Currency Union. By subregion, South America posted the highest average rate, at around 11.6 per cent, with Central America and Mexico posting rates slightly over 4 per cent on average. Several economies in the Caribbean also saw inflation rise over the December 2013 figure (see figure VII).

Figure VII

Latin America and the Caribbean: 12-month cumulative variation in consumer price index, 2010-2014

(Percentages)



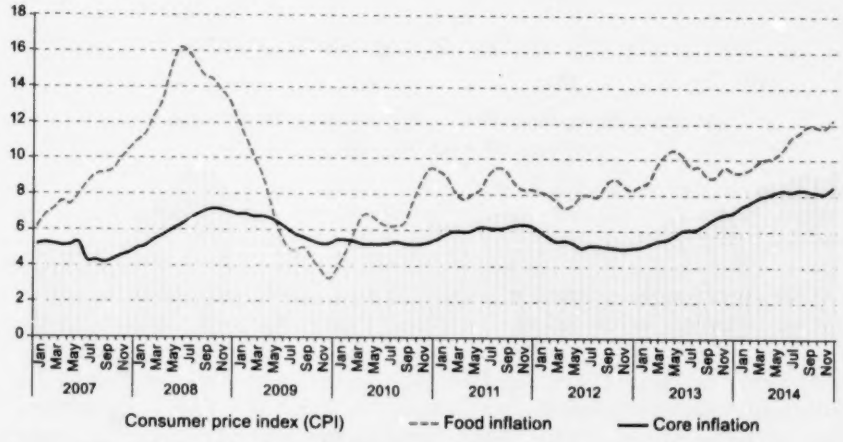
Source: ECLAC, on the basis of official figures.

37. The higher regional inflation figure reflected a rise in both food prices and core inflation. Food inflation ticked up sharply as of May 2014, and core inflation increased in most of the countries in the first half of the year. In the regional average, food prices were up by 12.2 per cent in the 12 months to December 2014 (as against a 9.3 per cent cumulative rise in the 12 months to December 2013 and 8.3 per cent in 2012), while core inflation rose to 9.1 per cent in the 12 months to October 2014, compared with 7.0 per cent in the 12 months to December 2013 and 5.1 per cent in 2012 (see figure VIII).

Figure VIII

Latin America and the Caribbean: 12-month cumulative rates of consumer price inflation, food inflation and core inflation, 2007-2014

(Percentages)



Source: ECLAC, on the basis of official figures.

C. Employment and wages

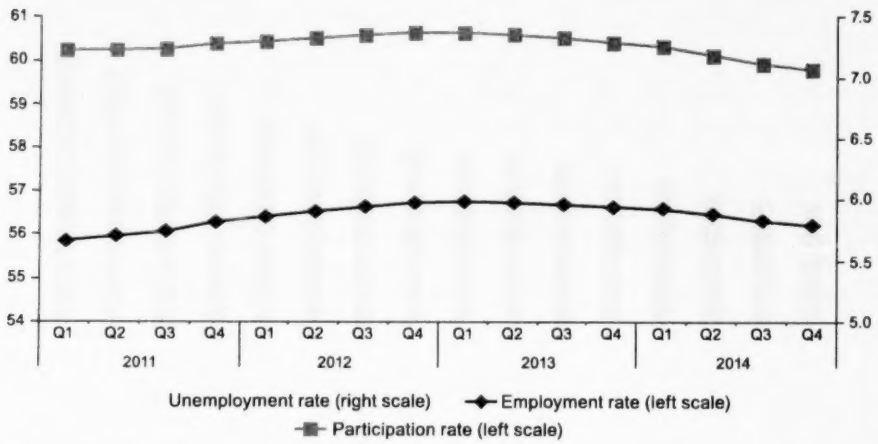
38. The patterns of the main labour variables in 2013 carried over into 2014 in Latin America and the Caribbean, with sluggish economic growth keeping labour demand subdued and limiting growth in the number of wage workers, which led to a fall in the employment rate. The region's participation rate also continued to fall faster than the employment rate, however, so urban unemployment eased down once again, notwithstanding the lacklustre economic conditions. For 2014 overall, the urban employment rate is estimated to have edged down to 56.5 per cent from 56.8 per cent in 2013, and urban participation to 60.1 per cent in 2014 from 60.6 per cent in 2013. As a result, the region's open unemployment rate came down again, although slightly, from 6.2 per cent to 6.0 per cent. The number of urban unemployed is estimated to have fallen by 300,000, to about 13.2 million.

39. Until 2012 (except for 2009), declining unemployment reflected a faster rise in employment than in participation, but in the rolling year from the third quarter of 2012 to the second quarter of 2013, when regional employment came down slightly, it was instead the result of a reversal in the participation rate, which began to fall faster than employment. As shown in figure IX, this pattern took firmer hold in 2014, with a steeper decline in both participation and employment.

Figure IX

Latin America and the Caribbean (10 countries):[a] participation, employment and unemployment rates, rolling years, first quarter 2011 to fourth quarter 2014

(Percentages)



Source: ECLAC, on the basis of official figures.

[a] Argentina, Brazil, Chile, Colombia, Ecuador, Jamaica, Mexico, Peru, Uruguay and Venezuela (Bolivarian Republic of).

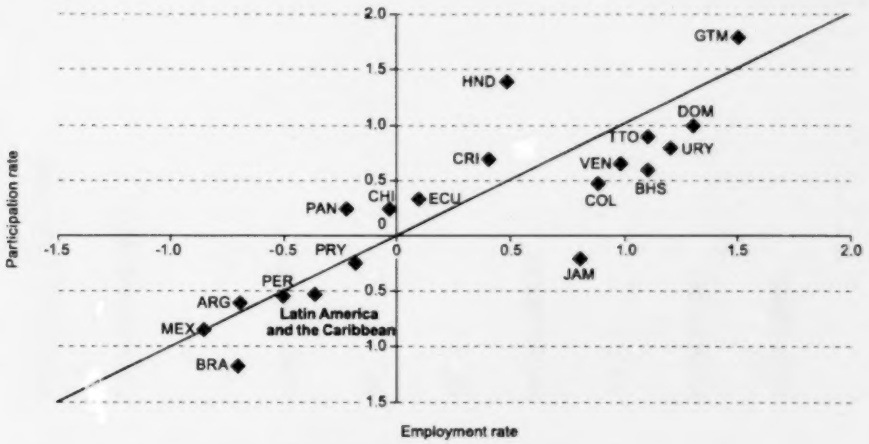
40. At the same time, this pattern regarding the main labour variables in the region did not occur evenly across all the countries. Figure X shows variation in the participation and employment rates for a group of countries in Latin America and the Caribbean. The diagonal line separates the countries with rises and falls in the unemployment rate. Brazil was the only country in which unemployment declined because of participation falling more than employment. However, a lower

participation rate also averted a hefty rise in unemployment in Peru and contained the increase in Argentina and Mexico. By contrast, the employment rate rose in several countries and helped to bring down unemployment in some of them, though not all. In fact, among the 18 countries for which these data are available, apart from Argentina and Mexico as mentioned above, only Chile, Costa Rica, Ecuador, Guatemala, Honduras and Panama posted (slightly) higher urban unemployment.

Figure X

Latin America and the Caribbean (18 countries): variation in urban participation and employment rates, average for 2014 with respect to average for 2013

(Percentage points)



Source: ECLAC, on the basis of official figures.

41. However, the cooling of economic growth at the regional level could not avoid impacting on labour demand. This took the form of weak wage employment creation in many countries, including Argentina, Brazil, Chile, Panama, Paraguay and Peru, where this category of employment grew less than 1 per cent or the absolute numbers contracted.

42. Own-account employment, which is usually of poorer quality than wage employment, expanded more than total employment in most of the countries, suggesting an incipient resurgence in informal activities in the context of weak labour demand from firms. In the median for 11 countries, total employment expanded 1.5 per cent, as did wage employment, while own-account employment grew 3.3 per cent.

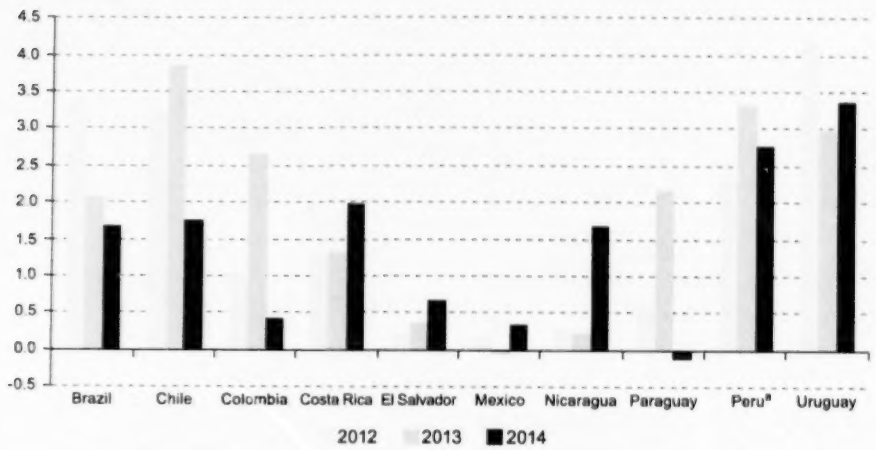
43. The weaker creation of quality employment was also observed in the data on the evolution of registered employment. Although formal employment continued to expand in the yearly average in all the countries for which information is available, it did so at falling rates which in very few cases exceeded 2 per cent. The main exception was Mexico, where policies recently launched to encourage employment formalization helped to increase the momentum in employment registration in the second half of 2014, leading to an annual rate similar to that of 2013.

44. The fact that the region's labour markets were not yet under heavier supply-side pressure in 2014, which would have generated new imbalances, was reflected not only in the falling participation rate and the fact that there was no strong expansion of the informal sector, but also in the evolution of formal sector real wages. In the simple average for the countries, real wages rose 1.8 per cent, similarly to the 2013 figure. However, they rose less than in 2013 in almost all the South American countries for which information is available, while in the Central American countries with information available and in Mexico, they rose above 2013 rates.

Figure XI

Latin America (selected countries): variation in real average wage in formal employment, 2012-2014

(Percentages)



Source: ECLAC and the International Labour Organization (ILO), on the basis of official information from the countries.

[a] Refers to dependent workers in Metropolitan Lima.

45. Real wage stability or slight rises were aided by minimum wage policies. In the simple average for 20 countries, real minimum wages were up by 3.1 per cent, with two-digit increases in the Plurinational State of Bolivia and Panama. The minimum wage rose below inflation or not at all in a very few countries only.

IV. Economic policy responses in Latin America and the Caribbean

A. Fiscal policy

46. Preliminary information on the fiscal accounts of Latin America and the Caribbean show the fiscal balance deteriorating slightly, on average, in 2014. The region's primary deficit (before public debt interest payments) is expected to stand at 0.8 per cent of GDP, and the overall central government deficit will widen from 2.4 per cent of GDP in 2013 to 2.7 per cent in 2014 (see figure XII), with a drop in

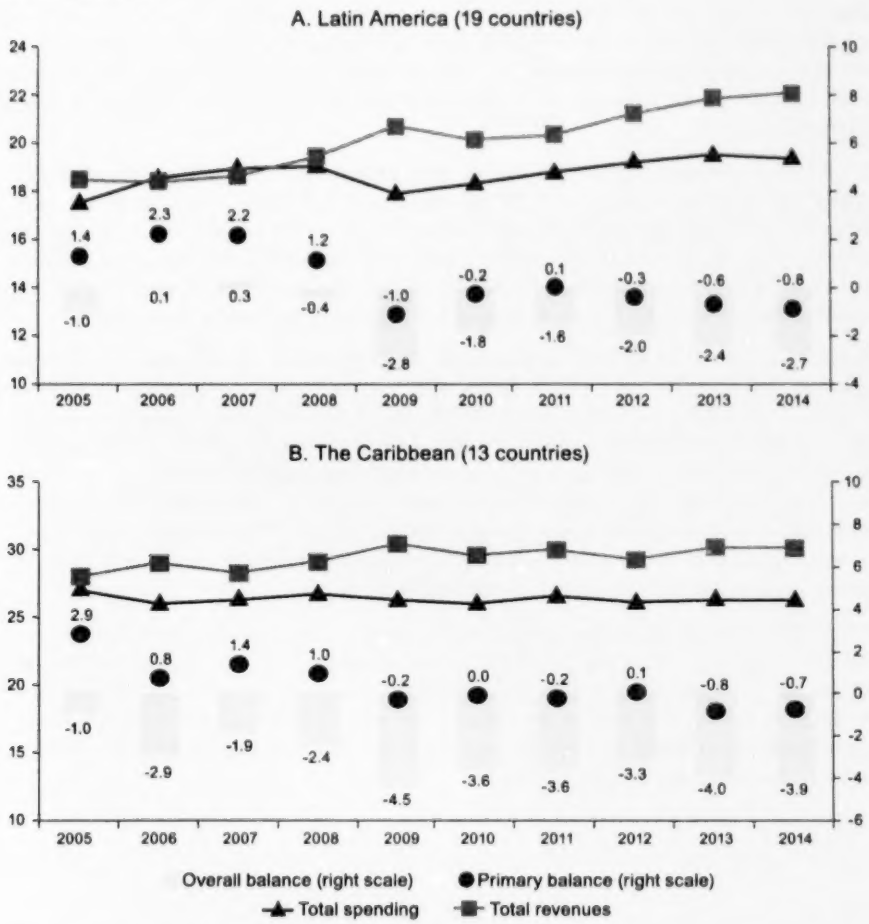
total revenues and a slight upturn in public spending. The region as a whole has posted a fiscal deficit since 2009, but this has not pushed up public debt, which has held steady at about 32 per cent of GDP, with an external component of less than 15 percentage points of GDP.

47. The Caribbean should see its fiscal position remain relatively stable in 2014, with the overall average deficit at the central government level shrinking from 4.0 per cent of GDP in 2013 to 3.9 per cent in 2014 (see figure XII). Nevertheless, the subregion's debt levels remain high, at close to 80 per cent of GDP on average, with a substantial external component.

Figure XII

Latin America and the Caribbean: central government fiscal indicators, 2005-2014[a]

(Percentage of GDP)



Source: ECLAC, on the basis of official figures.

[a] Simple averages. The data for 2014 are estimates.

48. Total fiscal revenues fell in the oil-exporting countries and tax revenues rose slightly in several of the region's economies. Estimates for Latin America show total fiscal revenues down by 0.2 percentage points of GDP on average in 2014. In 12 of the 19 countries analysed, the year-on-year variation was less than 0.5 percentage points of GDP, though some countries did see more significant changes. Fiscal revenues rose markedly in Argentina (by the equivalent of 2.9 percentage points of GDP), Honduras (1.8 percentage points) and the Dominican Republic (0.6 percentage points). By contrast, fiscal revenues fell considerably in Venezuela (Bolivarian Republic of) (3.7 percentage points), Haiti (1.8 percentage points), Ecuador (1.7 percentage points) and Mexico (1.3 percentage points).

49. The performance of tax revenues in the Caribbean diverged by type of exporter, falling in countries that export non-renewable natural resources but climbing strongly in exporters of services, thanks to the economic upturn.

50. Several countries in the region have carried out tax reforms in recent years.[2] Although a variety of changes have been made, one of the most notable developments with respect to previous decades has been the focus on income tax, not only for the purpose of improving revenue collection, but also to strengthen one of the weakest points of regional fiscal policy: the impact of tax systems on income distribution.

51. Overall, the countries of the region were able to maintain public spending and investment as a percentage of GDP. Capital spending also held steady or even increased as a share of GDP in many countries in 2014. It was down in Central America and the Dominican Republic, however, as well as in the oil-exporting countries, which nevertheless — especially in the case of Ecuador and the Plurinational State of Bolivia — kept up very high levels of public investment.

52. The countries with low public debt (and therefore more readily available financing) have reacted to the slowdown with more active fiscal policies. In Peru, a set of initiatives adopted in November 2014, with a view to accelerating growth and reducing the costs and time frame for the implementation of public and private investment projects, is expected to give a boost equivalent to 2 per cent of GDP. Chile has lined up an expansionary budget for 2015, increasing spending on non-financial assets (investment and capital transfers) by 27.5 per cent. Meanwhile, the upward trend in investment spending will continue in the Plurinational State of Bolivia, with much of it going to the infrastructure sector.

53. In countries with higher levels of public debt or financing difficulties, the weaker public accounts forecast for 2015 have prompted announcements of budget cuts for the year ahead. In this regard, spending containment measures should take into account the need to protect investment and avoid vicious circles whereby fiscal overadjustments strangle growth and tax revenues, ultimately widening the deficit and increasing the public debt burden.

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[2] See ECLAC, *Fiscal Panorama of Latin America and the Caribbean: Tax reform and renewal of the fiscal covenant* (LC/L.3580), Santiago, Chile, 2013; J. Gómez-Sabaini and D. Morán, "Tax policy in Latin America: Assessment and guidelines for a second generation of reforms", *Macroeconomics of Development* series, No. 133 (LC/L.3632), Santiago, Chile, 2014.

B. Monetary, exchange-rate and macroprudential policies

54. On the monetary and exchange-rate front, countries in the region adopted a mainly countercyclical approach in 2014, regardless of policy regime. More emphasis was placed on stimulating aggregate demand and setting and monitoring medium-term inflation targets. At the same time, authorities sought to mitigate the effects of external volatility on the region's financial markets by using international reserves and making changes to macroprudential regulations.

55. Thus, in Chile, Mexico and Peru, three of the five economies that use inflation targeting, monetary authorities reduced policy rates to stimulate aggregate domestic demand, even though inflation breached the upper limit of the target range in 2014. In Brazil and Colombia, the authorities adopted a prudent stance and increased policy rates as the gap between utilized and installed capacity narrowed and consumption growth threatened to exceed forecast scenarios.

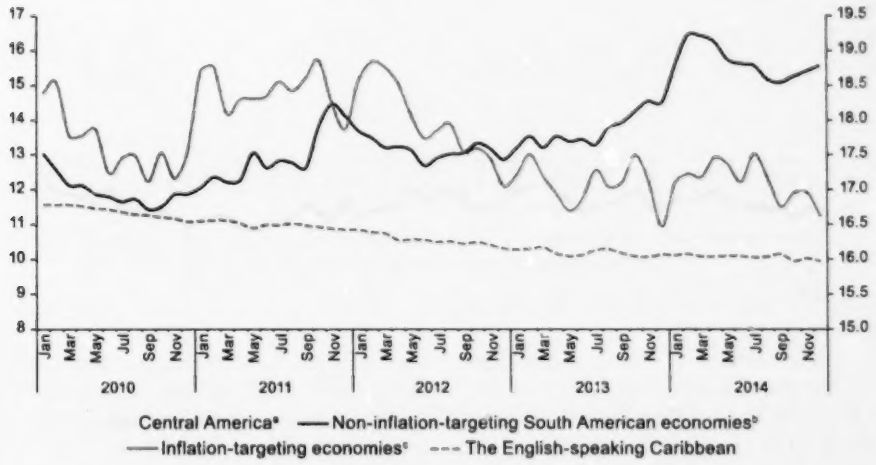
56. In most of the economies that use monetary aggregates as their principal policy instrument, the monetary base grew at a slightly faster pace in 2014. Since mid-2013 the expansion of the monetary base had been slowing in most of the region's economies, but this trend was reversed in 2014.

57. This monetary policy slant has led to a marked reduction in lending rates in the inflation-targeting economies (except Brazil), in the English-speaking Caribbean and, to a lesser extent, in Central America. In the non-inflation-targeting South American economies, average lending rates were higher than in 2013, though they did fall in absolute terms over the year, as in the rest of the region.

Figure XIII

Latin America and the Caribbean: average lending rates by subregion, 2010-2014

(Percentages)



Source: ECLAC, on the basis of official figures.

[a] Costa Rica, Dominican Republic, El Salvador, Guatemala, Haiti, Honduras, Nicaragua and Panama.

[b] Argentina, Bolivia (Plurinational State of), Ecuador, Paraguay, Uruguay and Venezuela (Bolivarian Republic of).

[c] Brazil, Chile, Colombia, Mexico and Peru.

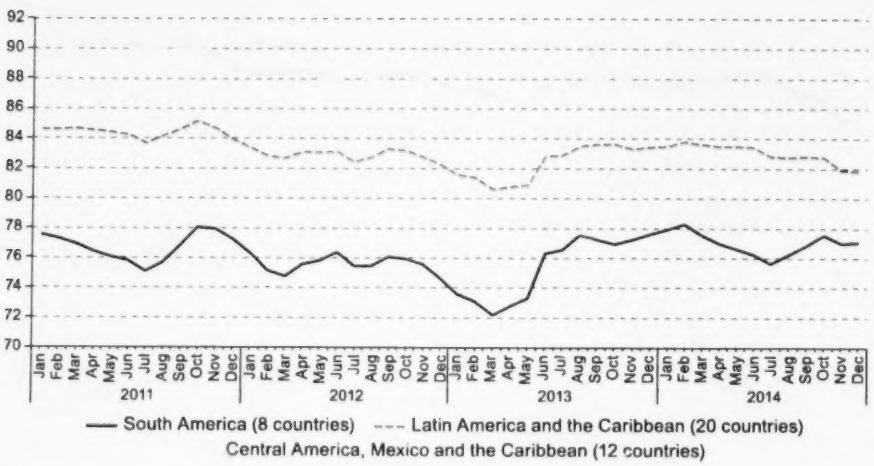
58. However, despite the monetary stimulus and predominantly declining interest rates, growth in domestic credit to the private sector continued to slow in 2014. The exception was the South American economies, where this variable picked up somewhat, especially in the Bolivarian Republic of Venezuela. The prevailing conditions in international financial markets, particularly the announcements of monetary policy normalization in the United States, heightened exchange-rate volatility in the region and resulted in the depreciation of some currencies under flexible exchange-rate regimes. The Brazilian real, the Chilean peso and the Colombian peso continued to reflect the volatility seen since late 2013, when the United States Federal Reserve announced the tapering of its liquidity injection programme. Between December 2013 and December 2014, the Chilean peso depreciated by 16 per cent, the real by 13 per cent and the Mexican peso by 12 per cent. In the same period, the Colombian peso declined by 22 per cent and the Peruvian sol by 6 per cent.

59. These exchange-rate developments, together with the relative paces of inflation in the region's economies, resulted in an appreciation of the real effective extraregional exchange rate, especially in the economies of South America.

Figure XIV

Latin America and the Caribbean: real effective extraregional exchange rates, 2011-2014

(Index 2005=100)



Source: ECLAC, on the basis of official figures.

60. In response to these developments, authorities in the region drew on international reserves in order to mitigate exchange-rate volatility. The central banks of Costa Rica, the Dominican Republic, Jamaica, Peru and Trinidad and Tobago, among other economies, intervened in the foreign-exchange markets in an effort to stave off local currency depreciation, while authorities in other economies, including Colombia, maintained their foreign-currency purchase programmes, thus boosting their reserve position.

61. In spite of these efforts to reduce exchange-rate volatility, the level of international reserves rose slightly from $830 billion in December 2013 to

$857 billion in December 2014. Nevertheless, the pace of reserve accumulation in 2014 was considerably slower than in the period before 2012. Reserves edged up from 14.0 per cent of GDP in 2013 to 14.4 per cent in 2014, but remained below the late-2012 level of 14.5 per cent.

62. The countries of the region continued to strengthen financial sector regulation and oversight and adapt their management of reserves and capital flows to the new external context. In 2014 several changes were made to macroprudential regulations with respect to the following areas: (a) legal reserve requirements on bank deposits in Bolivia (Plurinational State of), Brazil, Peru and Venezuela (Bolivarian Republic of); (b) minimum capital requirements for financial institutions in Brazil and Nicaragua; (c) investment limits on the basis of residency or currency criteria in Argentina, Costa Rica, Jamaica, Peru and Uruguay; and (d) the regulatory framework of the financial system in Costa Rica, Jamaica, and Trinidad and Tobago.

V. Outlook and challenges

63. Although projections indicate a trend towards a moderate uptick in global growth, a number of serious risks persist in various world regions that could threaten that outcome. International trade projections also suggest that the region's possibilities of leveraging its export potential could be limited. This is in addition to risks associated with raw materials values; prices for the region's main export commodities are expected to remain low, compared with the highs in 2011, although they did show signs of stabilization and recovery at the start of 2015.

64. However, developments in the global economy will again have a mixed impact on the region. In general, the South American economies will be the worst affected by the drop in commodity prices and by the slower growth in China and Europe, while the Central American and Caribbean economies will benefit from growth in the United States economy and from lower oil prices.

65. Exports are expected to remain weak in South America, but to expand in most Central American countries. Overall, the region's goods trade balance is projected to worsen with respect to 2014 and this will likely cancel out the upturns in the other current account items, which could leave the overall current account balance at a similar level to 2014.

66. Another factor shaping the region's performance is the great uncertainty prevailing in international financial markets, generated on the one hand by the effects of monetary policy normalization in the United States, which will depend on the pace and magnitude of the adjustment, and on the other by uncertainty in the eurozone. These factors could complicate prospects for financing the current account deficit in 2015.

67. Bond issues in the first quarter of 2015 appear to be continuing the downturn begun in the second half of 2014: at $29 billion, they represented just a third of the amount issued in the prior-year quarter. This more limited access to external financing could continue for the rest of the year while, apart from the negative impact of falling commodity prices on most of the region's countries, external financing will also be affected by increasing risk aversion, the lower growth outlook for some of the countries — and even economic contraction in some cases — and the prospects of a rise in external interest rates.

68. The regional economy is projected to post average growth of 1.0 per cent in 2015. As in 2014, growth patterns will vary between countries and subregions, owing, among other things, to the differentiated impact of the external context. Projections are for growth of 4.0 per cent for Central America, including the Spanish-speaking Caribbean and Haiti, a standstill in output for South America stand and growth of 1.9 per cent for the English- and Dutch-speaking Caribbean.

69. Inflation is expected to slacken in most of the region's economies, owing to the impacts of falling prices for primary goods, especially energy.

70. In addition, the urban employment rate is likely to fall for a third year running, owing to the weak labour demand — and therefore weak wage job creation — attendant on low economic growth. Employment quality could well suffer as a result and, with formalization probably being insufficient to offset weak wage employment creation, registered employment will continue its lacklustre gains in most of the countries.

71. In this context, the fall in labour market participation cannot be expected to continue at the regional level, at least not at the rate seen in 2014. Accordingly, the decline in the employment rate will probably be reflected in a rise in the open unemployment rate in 2015. This rise could reach around 0.2 percentage points, taking unemployment back to 6.2 per cent, the rate posted in 2013. For most of the countries, average real wages in the formal sector should hold steady or rise slightly, since unemployment rates will generally continue relatively low and, with few exceptions, inflation should tend to ease.

72. To offset the effects of increased volatility, reduced availability of funds and slacker external demand from emerging economies, policymakers will be obliged to make greater use of the policy tools at their disposal. On the monetary policy front, where possible this will mean boosting aggregate demand through measures to stimulate financial intermediation.

73. Stimulating economic growth and reversing the slowdown poses broad challenges for the region in the current global conditions. Weak growth in the developed countries and modest expansion in the emerging economies, together with the post-crisis dynamics of world trade, suggest that boosting the region's external demand will be a slow and difficult process, which will limit the contribution of exports to growth. Therefore, although international trade remains a source of opportunity, the region must redouble its efforts to build competitiveness in existing external markets and open up new ones.

74. In this context, regional integration processes can help to boost aggregate demand through trade integration. They can boost productivity and competitiveness through value chains and the integration of production and infrastructure. Through financial integration, regional cooperation builds capacity to withstand external shocks.

75. Since the 2009 financial crisis, domestic demand has been the main driver of growth in the region, while net exports made a negative contribution to growth between 2010 and 2013. Against this backdrop, along with boosting its export potential, the region must sustain and increase domestic demand to reverse the slowdown. Loss of momentum in investment — a key component of domestic demand — has been one of the key factors behind the slowdown in many of the economies of Latin America and the Caribbean. That is why the primary challenge

now facing the region's countries in terms of boosting economic growth is to increase public and private investment rates.

76. The ability of countries to boost public investment depends on their current fiscal position and their capacity to mobilize resources. In this respect, 2015 will bring significant challenges for the governments of the region. On the one hand, the economic slowdown — and, in some countries, even the possibility of a contraction — will depress public revenues. At the same time, income from non-renewable natural resources, which represents a significant proportion of total revenues in Bolivia (Plurinational State of), Chile, Colombia, Ecuador, Mexico, Peru and Venezuela (Bolivarian Republic of), will fall year-on-year by comparison with 2014. On the other hand, some of the net hydrocarbon importers have significant subsidy schemes, and in these cases the fiscal position will tend to improve.

77. At the same time, Governments are understandably cautious about considering cuts in social spending after the positive impacts on poverty reduction achieved through social expenditure during the past decade, and especially in view of the great needs existing in the region. It is also increasingly recognized that public investment cuts, the typical shortcut to fiscal consolidation in the region, carry significant long-term economic costs. As a result, many of the region's countries are reviewing their budgets with an eye to this complex challenge.

78. In countries with higher levels of public debt or financing difficulties, the weaker public accounts forecast for 2015 have prompted announcements of budget cuts for the year ahead. In this regard, spending containment measures should take into account the need to protect investment and avoid vicious circles whereby fiscal overadjustments strangle growth and tax revenues, ultimately widening the deficit and increasing the public debt burden.

79. In any case, on average the region's fiscal deficit has remained relatively stable and its external and domestic public debt levels, with the exception of the Caribbean, are relatively low. So, notwithstanding differences between countries, the region conceivably has the scope to expand public investment with a view to enhancing production capacity and competitiveness through infrastructure projects. This type of investment not only promotes productivity gains, but also serves as an incentive for private investment.

80. Treating greater public or public-enterprise investment as central to boosting overall investment poses new challenges in terms of countercyclical architecture in Latin America and the Caribbean. The region has made good progress on countercyclical policies to smooth public revenue flows in the event of cyclical changes in the sources of fiscal income, a development that has been crucial to sustaining economic growth and should be pursued further. At the same time, the countercyclical architecture needs to include mechanisms to ensure that investment — as an increasingly key variable of economic performance and growth — can be financed at the different phases of the cycle.

81. Strengthening the investment component not only helps to mobilize domestic demand in the short term and promote growth, but is also the main bridge between the challenges of the economic cycle and medium- and long-term growth and development. In this context, development macroeconomics should aim not only to smooth economic cycles, but also to enhance production development and structural change by armour-plating investment growth over time.

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Agenda item 15
Regional cooperation

Summary of the survey of economic and social developments in the Economic and Social Commission for Western Asia region, 2014-2015*

Note by the Secretary-General

The Secretary-General has the honour to transmit herewith a summary of the survey of economic and social developments in the Economic and Social Commission for Western Asia region for the period 2014-2015.

* After Libya, Morocco and Tunisia became States members of the Commission in July 2012, it was decided that the territorial coverage of the survey of economic and social developments in the Economic and Social Commission for Western Asia region would be expanded to include all the countries constituting the Arab region. The following subregional grouping is used herein, taking into account a combination of per capita income levels, geographical proximity and similarities in economic and social characteristics and conditions: Gulf Cooperation Council countries (Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and United Arab Emirates); Mashreq (Egypt, Iraq, Jordan, Lebanon, State of Palestine and Syrian Arab Republic); Maghreb (Algeria, Libya, Morocco and Tunisia); and Arab least developed countries (Comoros, Djibouti, Mauritania, Somalia, Sudan and Yemen).

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Summary of the survey of economic and social developments in the Economic and Social Commission for Western Asia region, 2014-2015

Summary

The average growth rate of the gross domestic product (GDP) of the Arab region in real terms is estimated to be 1.5 per cent in 2014, barely changed from 2013. Negative growth estimates for Iraq, Libya and the Syrian Arab Republic, attributed to intensifying armed conflicts, contributed to the deceleration. In addition to conflicts and related security disruptions in the region, a significant fall in oil prices and the uncertain prospects in that regard became another predominant economic concern. From its peak in June 2014, oil prices plunged by more than 50 per cent in the second half of the year. That significant shift notwithstanding, the member countries of the Gulf Cooperation Council (GCC) continued to lead the growth of the Arab region. While lower oil prices affect nominal national income, their impact is less obvious in price-adjusted real GDP figures because the level of crude oil production has barely changed. Moreover, the continuing expansion of the non-oil sector bolstered economic growth in the GCC countries. Lower oil prices have not yet affected economic sentiment in those countries, although business confidence has begun to wane, with weakening stock and real estate markets. Lower oil prices benefited oil-importing Arab countries, easing their balance-of-payment and fiscal constraints. The gain is, however, at risk of being offset by declining capital and remittances flows from GCC countries to other Arab countries. Against a backdrop of spreading armed conflicts and violence in the region and increasing disruptions of intraregional economic activities, one of the main channels for economic stabilization efforts was intraregional flows of capital and remittances from GCC countries. Although their short-term impact has been moderate, the fall in oil prices and its negative consequence on the fiscal position of GCC countries are still likely to have an impact on this stabilization mechanism in the region in the medium term. The Arab region is forecasted to grow on average by 2.4 per cent in 2015. The economic expansion of GCC countries is projected to decelerate, while other Arab subregions, with the exception of conflict-affected countries, are projected to register moderate growth, owing to the expected rise in domestic demand in view of the lower prices of imported fuel products and food items.

I. Global context

1. The world economy witnessed shifts in several important features in 2014. There was a split between the United States of America and the rest of the developed economies on monetary policy. Reflecting the robust economic recovery of the United States, its monetary policy has been on course to be normalized, with a rise in interest rates expected by the end of 2015. While interest rates in other developed economies are expected to remain at historic lows, the difference in projected interest rates caused a significant appreciation of the dollar against other major currencies, including the euro and the yen. A rapid fall in oil prices in the second half of 2014 rebalanced income distributions between oil-exporting countries and oil-importing countries. Meanwhile, the role of developing economies as leading centres of growth continued to abate, with the deceleration of the economic expansion of major developing economies, including Brazil and China. The consequence of these shifts in the world economy is not yet certain, but concerns are mounting about possible "secular stagnation", i.e., long-term stagnation and deflation of the world economy owing to debt.

2. The robust economic expansion of the United States continued in spite of the decrease in spending by the federal Government.[1] The active private sector, which has been recovering from the global financial crisis of 2008, led the growth. The resilience of the financial sector, backed by recovering asset prices, supported the expansion of the private sector. The stagnation of the European economy continued owing to slow private investment. The European Central Bank entered into a quantitative easing phase in 2015 to stimulate credit growth in the euro area, while the European Commission strategized an investment plan to boost private investment.[2] The debt crisis in Greece has deepened, posing a systemic risk to the financial system in the entire euro area. Japan failed to achieve an export-led recovery because domestic demand growth stagnated after the increase in the sales tax in April 2014. The economic expansion of developing economies decelerated further in 2014. Declining international commodity prices have weakened the impetus for growth in commodity-exporting countries to varying extents. Low commodity prices benefited commodity-importing countries by alleviating balance-of-payment constraints, but not enough to spur high economic growth. Among the major developing economies, Brazil, the Russian Federation and South Africa suffered from declining commodity prices, while China and India saw sizeable, albeit decelerating, economic growth rates in 2014.

3. While a moderate but noticeable decline in unemployment rates has been observed in several developed economies, including Germany, Japan, the United Kingdom of Great Britain and Northern Ireland and the United States, employment creation continued to stagnate in 2014. The global employment gap created by the global financial crisis of 2008 continued to widen, reflecting deteriorating

[1] United States Department of Commerce, Bureau of Economic Analysis, "Gross domestic product: fourth quarter and annual 2014 (third estimate); Corporate profits: fourth quarter and annual 2014", 27 March 2015. Available from www.bea.gov/newsreleases/national/gdp/2015/pdf/gdp4q14_3rd.pdf.

[2] European Commission, "An investment plan for Europe", document COM(2014)903, 26 November 2014. Available from http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52014DC0903&from=EN.

employment situations in developing economies.[3] Persistent, weak employment prospects in developed economies have resulted in growing political pressure to restrict immigration. In addition, the demand for foreign labour in resource-rich economies in the Arab region such as the States members of the Gulf Cooperation Council (GCC) is projected to decline. While several developed economies are likely to see slight improvements in their employment situation, further deterioration is expected in developing economies in 2015. Neither developed nor developing economies are likely to take substantial fiscal stimulus measures, instead adopting fiscal consolidation as the most important priority. Policy-led recoveries in employment creation are not likely in the near future, in particular in developing economies.

4. In this global context, several negative factors are noticeably influencing Arab economies in the period 2014-2015. Mounting geopolitical tensions, armed violence and mass displacement of populations in the region continue to be of concern. Declining oil prices have an impact not only on the fiscal positions of Arab oil-exporting countries, in particular GCC countries, but also on other Arab countries, by changing patterns of intraregional capital and remittance flows. The weak economic prospects of European economies continue to hamper non-oil exports from the region, especially the Maghreb countries. The anticipated rise of United States dollar interest rates is likely to have an impact on the funding costs of Arab countries. Meanwhile, a few positive factors have a bearing on the economic prospects of the region. As mentioned, low oil prices alleviate balance-of-payment and fiscal constraints of oil-importing countries. The continuing decline of other commodity prices, in particular food items, eases inflationary pressures. The consistent economic expansion of East and South Asian economies sustain the non-oil sector of the region, in particular in GCC countries. In addition, the robust economic recovery of the United States prevents regional economic sentiment from becoming overly pessimistic.

II. Developments in the natural resources sector

A. Oil sector

5. The global oil sector has entered a phase of structural change, triggered by a significant plunge in oil prices. By the second half of 2014, oil market participants had shifted their attention away from geopolitical tensions and supply disruptions to the issue of a supply glut. For the past few years, the global supply capacity of crude oil has been increasing rapidly, in particular in North America. A supply glut gradually became noticeable when demand for crude oil began to decelerate because of the stagnating world economy. Unlike the period 2008-2009, however, oil markets have not seen demand collapse. According to the Organization of the Petroleum Exporting Countries (OPEC),[4] the estimated total world demand for oil in 2014 was 91.2 million barrels per day on average, an increase of 970,000 barrels per day over the previous year. OPEC projects that that demand will continue to

[3] International Labour Office, *World Employment Social Outlook: Trends 2015* (Geneva, 2015), p. 16. Available from www.ilo.org/wcmsp5/groups/public/---dgreports/---dcomm/---publ/documents/publication/wcms_337069.pdf.

[4] "OPEC Monthly Oil Market Report", 16 March 2015, p. 92, tables 10.1 and 10.2. Available from www.opec.org/opec_web/static_files_project/media/downloads/publications/MOMR_March_2015.pdf.

grow at the same moderate pace in 2015 (about 1.2 million barrels per day).[4] OPEC also estimates that the total supply of crude oil, which averaged 92.2 million barrels per day in 2014, increased by just under 2 million barrels per day over the previous year.[4] While OPEC crude oil production edged down by 160,000 barrels per day to 30.1 million barrels per day in 2014, non-OPEC production increased by more than 2 million barrels per day to 56.3 million barrels per day. The estimated level of excess supply in 2014 stood at 1 million barrels per day. The level of supply could have been adjusted had the most influential OPEC producers decided to do so. OPEC decided, however, to maintain the production level of 30 million barrels per day in November 2014, while at the same time no non-OPEC crude oil producers committed themselves to reducing supply either. In 2015, market conditions are likely to curb the supply of costly crude oil from non-OPEC producers while OPEC maintains its current production level. The impact of low oil prices on global crude oil supply capacity is likely to become more apparent in the medium term, given that more oil companies have curtailed capital expenditure in both upstream and downstream areas.

6. The OPEC basket price averaged $96.3 per barrel in 2014 (see table 1). In the first half of 2014, major crude oil prices continued to remain above $100 per barrel, following the trend of the previous years. Oil prices reached their peak for the year in June, then fell over the subsequent seven months. The OPEC basket price reached $41.5 per barrel on 13 January 2015, a decline of 62 per cent from the peak in 2014. In addition to a supply glut, an increasing risk of rising funding costs resulting from the anticipated normalization of United States monetary policy has discouraged speculative buying in oil futures markets; rather, speculative short selling has contributed to weak oil prices. Demand growth for crude oil has decelerated, but not collapsed. Reflecting the increasing use of oil tankers, freight rates for the transport of crude oil remained firm throughout 2014. Crude oil prices are projected to approach their long-term trend, with increasing volatility through 2015 as market participants remain sensitive to any news of a supply glut. Crude oil prices are likely to test recent new lows in the second quarter in 2015 as inventories are projected to pile up owing to seasonal factors, in particular refinery maintenance. The inventory accumulation is likely to be more extensive in North America, which would result in a widening margin between geographical benchmark prices. The inventory level, however, is projected to come down in the third and fourth quarters and crude oil prices are likely to converge to a long-term trend line by the end of 2015. The OPEC reference basket price is forecasted to average $54.5 per barrel in 2015 in the forecasted range of $40.6 to $70.3.

Table 1
Crude oil price estimation and forecast, 2012-2016
(OPEC reference basket: United States dollar per barrel)

				Forecasted annual average		
Year	*Minimum*	*Maximum*	*Annual average*	*Lower*	*Baseline*	*Higher*
2012	88.74	124.64	109.45			
2013	96.35	114.94	105.87			
2014	52.00	110.48	96.29			
2015				40.6	54.5	70.3
2016				45.3	64.3	86.0

Source: OPEC for 2012-2014. Figures for 2015 and 2016 are forecasts by the Economic and Social Commission for Western Asia as at March 2015.

7. The total crude oil production of the Arab region in 2014 is estimated at 23 million barrels per day on average, a decrease of 500,000 barrels per day from the level in 2013. GCC countries are estimated to have produced 17.3 million barrels per day in 2014, the same level as the previous year. Libya and Yemen substantially reduced their production levels owing to intensifying armed conflicts in 2014, while Iraq saw growth because its major production facilities in the south of the country were not affected by the conflict. The Arab region's total gross revenues from oil exports are estimated to be $695 billion in 2014, a decline of 12 per cent from the previous year, and are forecasted to decline by a further 45.4 per cent in 2015, to $379.5 billion.

B. Natural gas sector

8. Natural gas constitutes another strategically important hydrocarbon resource in the Arab region and has become a major source of national wealth in those Arab countries that export it successfully. It provides an economical and environmentally efficient source for thermal power generation and is also used as a feedstock for the petrochemical industry. Arab countries have been witnessing rapidly growing domestic demand for natural gas, and not all gas-producing countries are yet export oriented. In 2014, Qatar remained the world's largest exporter of liquefied natural gas. Algeria has invested actively in enhancing its gas production capacity with a plan to explore shale gas production. Meanwhile, plans by Lebanon, the State of Palestine and the Syrian Arab Republic to explore offshore gas fields under the eastern Mediterranean have stalled.

9. Because of the need to invest heavily in transportation facilities to carry gas from producers to final users, whether through a pipeline or in the form of liquefied natural gas, the natural gas market remains more geographically segmented than that of crude oil. The extent of that segmentation was reflected in the wide margins in spot natural gas prices in Europe, Japan and the United States. As at January 2015, the benchmark price for Europe stood at $9.50 per million Btu, for Japan at $16 per million Btu and for the United States at $2.97 per million Btu.[5] Natural gas prices plummeted in 2014 as they did for crude oil, but to a lesser extent: while Dated Brent crude prices plunged by 55 per cent in the year to January 2015, the natural gas spot price fell by 12.8 per cent in Europe, 9.9 per cent in Japan and 39.2 per cent in the United States. Owing to the difference in the price dynamics of natural gas, the decrease in revenues from exports of natural gas by Arab countries is projected to be more moderate than that from crude oil exports over 2014 and 2015, in view of the fact that the destinations of the exports are either Europe or Asia. While some gas price transactions are linked to oil prices, multi-year fixed-price contracts are more common in the natural gas trade, which is likely to contribute to relative stability in the revenues of gas-exporting countries.

C. Phosphate sector

10. Increasing competition in downstream areas of the global fertilizer market continues to be a challenge in the phosphate sector. According to estimates from the

[5] International Monetary Fund, IMF Primary Commodity Prices, Monthly Database. Available from www.imf.org/external/np/res/commod/index.aspx.

International Fertilizer Industry Association, world fertilizer demand was expected reach 183.8 million tons during the 2014/15 planting season, of which 41.5 million tons were demand for phosphorus nutrient.[6] While global demand is expected to grow only moderately in the short and medium terms, the supply capacity of phosphate rock and phosphate acid is projected to expand in China, Jordan and Morocco. The supply capacity of diammonium phosphate, one of the most widely used phosphorus fertilizers, is also projected to grow more swiftly than demand.

11. From its peak in January 2012 to December 2013, the price of phosphate rock had registered a decline of 51 per cent over the two years. The year 2014 saw a moderate recovery, from $102.20 per ton in January to $115.00 per ton in December.[7] The price of diammonium phosphate followed a parallel trend, showing a moderate increase throughout 2014 from $438.30 per ton in January to $459.60 per ton in December. Stable price movements of phosphate rock and diammonium phosphate are projected during 2015, with possible downward adjustments owing to the growing global supply capacity. Moreover, the reform of export tariffs on phosphate products in China may have an impact on the global fertilizer market by improving the price competitiveness of Chinese exports.

III. Regional economic and social trends

A. Overview

12. Average real gross domestic product (GDP) growth in the Arab region is estimated to be 1.5 per cent in 2014, a slight change from the level registered in 2013 (see table 2). A major factor in the fluctuation is negative growth estimates for Iraq, Libya and the Syrian Arab Republic. The falling oil prices in the second half of the year notwithstanding, GCC countries remained the growth centre of the Arab region in 2014. However, the recent trend of polarized economic performances between GCC countries and the other Arab countries will come to an end with lower oil prices. Lower oil prices benefited oil-importing Arab countries, easing their balance-of-payment and fiscal constraints. Intensifying armed conflict and violence in Iraq, Libya, the State of Palestine, the Syrian Arab Republic and Yemen continued to divert the course of Arab socioeconomic development.

B. Gulf Cooperation Council countries

13. The subregion of GCC countries is estimated to have had GDP growth of 4.0 per cent in 2014, compared with 3.7 per cent in the previous year. In real terms, the fall in oil prices has had a mild impact on GDP figures because the level of crude production remained the same. Stable growth of the non-oil sector has been observed throughout the GCC countries. With the exception of Kuwait, GCC countries exhibited strong growth in domestic demand until the third quarter of

[6] International Fertilizer Industry Association, "Short-term fertilizer outlook 2014-2015", November 2014. Available from www.fertilizer.org/en/ItemDetail?iProductCode=9840Pdf&Category=ECO.

[7] World Bank, Global Economic Monitor Commodities Database. Available from http://databank.worldbank.org/data/views/variableselection/selectvariables.aspx?source=Global-Economic-Monitor-%28GEM%29-Commodities.

2014, indicated by the stable growth of broad money. A deceleration in the growth rate of broad money in the fourth quarter of 2014 in Saudi Arabia and the United Arab Emirates, however, indicates a shift in economic sentiment and business confidence. In parallel with declining oil prices, the value of financial assets and real estate entered a downward adjustment phase, in particular in the United Arab Emirates where the value had recorded remarkable growth for the past three years. The extent of the current decline should not, however, have as much of an impact on GCC countries as it did during the global financial crisis of 2008. The financial sector of GCC countries was much healthier and had more limited exposure to risky assets. The relatively strong economic performance of East Asia and South Asia supported the non-oil sector of GCC countries.

14. The GDP growth rate is projected to edge downwards in the GCC subregion in 2015. Lower oil prices are likely to erode economic sentiment and business confidence further in non-oil sectors, especially real estate. The expectation of rising funding costs in parallel with the anticipated rise in interest rates in the United States by the end of 2015 would also negatively affect credit growth in GCC countries. The strong linkage of GCC countries with growing East Asia and South Asia is, however, likely to sustain the growth of non-oil sectors. The GCC Customs Union, which came into effect in January 2015, is expected to enhance intra-GCC trade. The average real GDP growth rate of the subregion is estimated at 3.4 per cent for 2015. Among GCC countries, Qatar and the United Arab Emirates are projected to grow above the subregional average. Both countries are expected to continue investments in infrastructure in preparation for hosting upcoming global events. The growth of Saudi Arabia is projected to slow down, owing mainly to a rapid policy response to the new level of oil prices. Public expenditure, mostly extrabudgetary expenditure, is expected to be reduced significantly. Bahrain, Kuwait and Oman are projected to mark consistent growth, with mild decelerations in 2015. The forecasted growth rate for 2015 is 3.2 per cent for Bahrain, 2.0 per cent for Kuwait, 3.0 per cent for Oman, 5.2 per cent for Qatar, 3.0 per cent for Saudi Arabia and 4.2 per cent for the United Arab Emirates.

C. Mashreq

15. The economies in the subregion of the Mashreq are, on average, estimated to have contracted by 0.6 per cent in 2014, after registering a contraction of 2.2 per cent in 2013. Armed conflicts and violence affected this subregion the most among Arab countries, with Iraq, the State of Palestine and the Syrian Arab Republic suffering from destruction of economic infrastructure and disruptions of supply chains. Iraq is estimated to have experienced negative growth owing to a contraction of domestic demand. One of the fastest-growing regions in Iraq, the Kurdistan Region, has been severely affected by armed conflicts. Although growth in crude oil production was recorded in 2014, the fall of oil prices had a considerable impact on Iraqi government revenues. The destruction of economic infrastructure and production facilities continued in the Syrian Arab Republic in 2014, although production activities continued in the area that was relatively safe from armed violence. A limited resumption of production activities was reported, but private sector activities are severely constrained owing to frequent disruptions in energy supply and logistic chains. The destruction of economic infrastructure in the Gaza Strip in July 2014 had a negative impact on the Palestinian economy. Continuing

restrictions on economic activities have weakened domestic demand and hampered reconstruction efforts for the Gaza Strip. Jordan and Lebanon maintained a moderate expansion of domestic demand. The improved balance-of-payment conditions contributed to a historically high accumulation of foreign reserves in both countries during 2014. For Jordan, the rapid growth of quarrying activities also sustained the growth level. It should be emphasized, however, that the rate of growth of Jordan and Lebanon was significantly lower, owing to the rapidly growing influx of refugees and evacuees from the Syrian Arab Republic. Egypt has regained stability with increasing business confidence, registering consistent growth in 2014. The balance-of-payment conditions of Egypt have improved, with constant foreign capital inflows and declining international commodity prices.

16. For 2015, the Mashreq subregion is projected to grow by 1.2 per cent on average, after a contraction over the two previous years. The magnitude of the economic contraction of the Syrian Arab Republic is projected to diminish. Domestic demand in Iraq is projected to grow slightly. The growth of Jordan and Lebanon is expected to slow; both countries are likely to benefit from lower oil and commodity prices, but an economic slowdown in GCC countries is likely to weaken the spillover from those countries to Jordan and Lebanon. Egypt is likely to be a main driver of growth in the subregion in 2015. Further improvement of the balance-of-payment conditions in Egypt is likely to open a reasonable space to accelerate expansion of its domestic demand. The State of Palestine returned to economic expansion, owing mainly to a scale effect from a low base in 2014. The forecast is based on a moderate acceleration of reconstruction activities in the Gaza Strip, but the geopolitical situation makes this possibility elusive. The forecasted growth rate for 2015 is 3.2 per cent for Egypt, 0.5 per cent for Iraq, 2.8 per cent for Jordan, 3.0 per cent for Lebanon and 3.0 per cent for the State of Palestine. The Syrian Arab Republic is forecasted to contract by 7.0 per cent in 2015.

Table 2
Real GDP growth rate and consumer price inflation rate, 2012-2016
(Annual percentage change)

	Real GDP growth rate					*Consumer price inflation rate*				
Country area	*2012[a]*	*2013[a]*	*2014[b]*	*2015*	*2016[c]*	*2012*	*2013*	*2014[b]*	*2015[c]*	*2016[c]*
Bahrain	3.4	5.3	4.7	3.2	4.0	2.8	3.3	2.7	2.5	2.7
Kuwait	6.6	1.5	2.2	2.0	3.0	3.2	2.7	2.9	2.7	3.0
Oman	7.1	3.9	3.2	3.0	3.2	2.9	1.1	1.0	1.2	2.0
Qatar	6.0	6.3	6.2	5.2	5.5	1.9	3.1	3.0	2.7	3.2
Saudi Arabia	5.4	2.7	3.6	3.0	3.5	2.9	3.5	2.7	2.5	3.0
United Arab Emirates	4.7	5.2	4.5	4.2	4.5	0.7	1.1	2.2	2.0	2.2
GCC countries	**5.5**	**3.7**	**4.0**	**3.4**	**3.9**	**2.3**	**2.6**	**2.5**	**2.3**	**2.8**
Egypt[d]	2.2	2.1	2.2	3.2	3.8	7.4	10.3	10.1	10.0	9.5
Iraq	10.3	4.2	(2.6)	0.5	5.0	6.2	1.8	2.2	3.5	3.5
Jordan	2.7	2.8	3.1	2.8	3.0	4.5	4.8	2.9	2.5	3.0
Lebanon	2.8	3.0	3.2	3.0	3.0	6.5	5.6	1.7	1.5	2.0
State of Palestine	6.3	2.2	(2.5)	3.0	3.2	2.8	1.7	1.7	2.5	3.0

Country area	Real GDP growth rate					Consumer price inflation rate				
	2012[a]	2013[a]	2014[b]	2015	2016[c]	2012	2013	2014[b]	2015[c]	2016[c]
Syrian Arab Republic[e]	(30.9)	(36.5)	(10.5)	(7.0)	(5.0)	37.2	87.7	24.8	37.8	15.0
Mashreq	**0.1**	**(2.2)**	**(0.6)**	**1.2**	**2.8**	**10.6**	**17.3**	**8.8**	**10.7**	**7.6**
Algeria	3.3	2.8	3.2	2.8	3.5	8.9	3.3	2.1	2.7	3.0
Libya	98.2	(19.9)	(32.7)	(7.5)	12.0	6.1	2.6	1.3	4.0	4.5
Morocco	2.7	4.4	2.4	4.2	3.5	1.3	1.9	0.4	1.0	1.2
Tunisia	3.9	2.4	2.3	2.7	3.2	5.6	6.1	5.5	4.5	4.0
Maghreb	**21.1**	**(1.1)**	**(3.9)**	**1.2**	**5.1**	**6.1**	**3.2**	**1.9**	**2.7**	**3.0**
Comoros	3.0	3.5	3.7	3.5	3.5	6.3	1.6	2.5	2.0	2.0
Djibouti	4.8	5.0	5.0	4.8	4.5	3.7	3.5	2.2	2.0	2.5
Mauritania	7.0	6.7	5.9	6.1	6.2	4.9	4.1	3.6	3.2	3.5
Somalia	–	–	–	–	–	–	–	–	–	–
Sudan	0.4	3.6	2.5	2.8	3.0	35.1	37.1	37.5	17.0	15.0
Yemen	2.2	3.2	1.5	(2.0)	3.2	10.2	11.0	8.0	11.5	12.0
Arab least developed countries	**1.2**	**3.6**	**2.4**	**1.5**	**3.2**	**26.3**	**27.8**	**27.2**	**14.7**	**13.5**
Total Arab region[f]	**6.8**	**1.5**	**1.5**	**2.4**	**3.8**	**6.0**	**7.3**	**5.1**	**4.9**	**4.4**

Source: National sources.

[a] GDP figures for 2012 and 2013 are from *National Accounts Studies of the Arab Region*, Bulletin No. 34 (United Nations publication, Sales No. B.15.II.L.3), which were based on national sources, and the latest available figures from national sources as at March 2015.

[b] March 2015 estimates.

[c] March 2015 forecasts.

[d] For the GDP growth rate of Egypt, the figures are for the country's fiscal year, which ends in June.

[e] The GDP growth rates of the Syrian Arab Republic for 2012-2014 are the estimated figures contained in Syrian Center for Policy Research, "Alienation and violence: impact of Syria crisis report 2014" (Damascus, March 2015), available from www.unrwa.org/resources/reports/alienation-and-violence-impact-syria-crisis-2014.

[f] Figures for country groups are weighted averages, where weights for each year are based on GDP in 2010.

D. Maghreb

17. The economies of the Maghreb subregion are estimated to have contracted on average by 3.9 per cent in 2014, following a contraction of 1.1 per cent in 2013. The average growth of the subregion continued to be heavily influenced by the growth estimation for Libya, whose economy is estimated to have recorded two consecutive annual contractions. While political instability and armed conflicts substantially depressed Libyan domestic demand, Libyan oil production and exports dwindled owing to sabotage and work stoppages during 2014. The fall in agricultural output slowed the growth rate of Morocco in 2014, while other sectors maintained stable growth. Constant growth in domestic demand was indicated by accelerating broad money growth throughout 2014; however, stagnating European economies had a negative impact on exports. Tunisia experienced decelerating economic growth as a result of managed domestic demand in the face of difficult balance-of-payment conditions. Although the depletion of foreign reserves has been contained, the country remained in a weak external position. Stagnating European economies also had a negative impact on the Tunisian economy. Active public investments drove

growth in Algeria in 2014, the declining oil prices in the second half of the year notwithstanding. Domestic demand is estimated to have consistently expanded as broad money growth accelerated during the year.

18. For 2015, the Maghreb subregion is projected to grow by 1.2 per cent. The contraction of the Libyan economy is forecasted to continue, but less dramatically. A certain level of crude oil production and exports is projected to be maintained, but the displacement of foreign workers, some of whom were essential in managing the economic infrastructure, may result in a further decline in the level of economic activity. Morocco is forecasted to register accelerated growth, based upon a forecasted growth in food production. Low oil prices benefit Morocco and Tunisia, easing balance-of-payment and fiscal conditions. More space for domestic demand expansion is likely to be created in Tunisia, leading to a mild acceleration of growth, although spillover from the armed conflict in Libya poses a downside risk to security. The economic expansion of Algeria is projected to decelerate owing to the decline in its revenues from hydrocarbons; however, continuing active public investment is likely to buoy domestic demand. In 2015, the forecasted growth rates are 2.8 per cent for Algeria, 4.2 per cent for Morocco and 2.7 per cent for Tunisia. The Libyan economy is projected to contract by 7.5 per cent.

E. Arab least developed countries

19. The economies of Arab least developed countries are estimated to have grown, on average, by 2.4 per cent in 2014, following growth of 3.6 per cent the previous year. The Sudan managed to maintain positive economic expansion amid severe balance-of-payment conditions. The loss of oil export revenues since the separation of South Sudan notwithstanding, the Sudan managed to diversify its exports to other commodities, including food items and gold. The economic growth of Yemen decelerated. Domestic demand expansion has been weakened by an increasingly unstable political situation. Crude oil production in Yemen stagnated, with aging production facilities and continuous sabotage of oil pipelines. External financial support sustained monetary stability, but foreign reserves continued to decline in 2014. The Comoros maintained stable growth in 2014 in line with its long-term trend. The high level of port activities, driven partly by the growing transport of goods to Ethiopia, resulted in the constant economic expansion of Djibouti. Occasional security incidents notwithstanding, Somalia is estimated to achieve a rapid economic recovery owing to the continuing reconstruction work. Mauritania has experienced a deceleration of economic growth. Declining metal prices had a negative impact on its export performance, but domestic demand is estimated to see constant expansion.

20. For 2015, the real GDP growth of the Arab least developed countries is projected to average 1.5 per cent. The balance-of-payment conditions are projected to improve for the Sudan, which is likely to open space for domestic demand expansion. Further intensification of armed conflict and political instability are likely to force Yemen into an economic contraction. Lower commodity prices would benefit the Comoros and Djibouti, but domestic demand expansion is projected to taper off as broad money growth slows down. The expansion of the mining sector is projected to continue in Mauritania, even in the face of projections of weak metal prices. The expected growth of foreign direct investment in the sector would have a positive impact on the country's domestic demand expansion. These positive

manifestations of economic expansion notwithstanding, they appear to be insufficient to change the poverty profiles of the Arab least developed countries. More international and regional efforts are needed to alleviate poverty in the subregion. In 2015, the forecasted growth rate is 3.5 per cent for the Comoros, 4.8 per cent for Djibouti, 6.1 per cent for Mauritania and 2.8 per cent for the Sudan. Yemen was projected to register a contraction of 2.0 per cent, but the forecast is subject to a substantial downward revision if the armed conflict intensifies further.

F. Price and inflation

21. The average annual consumer price inflation in the Arab region is estimated to be 5.1 per cent in 2014, compared with 7.3 per cent in 2013 (see table 2). Falling international commodity prices contributed to the overall decline. While much of the attention was focused on oil prices, food prices also declined during 2014. The main driver of inflation in the GCC countries remains the rising price of housing-related items, reflecting the recovery of rental property. Amid intensifying armed violence and social unrest, both Iraq and Libya successfully kept inflation levels low through subsidies. Inflation was also contained in the State of Palestine. Low inflation rates do not, however, necessarily imply a sufficient supply of essential goods in those conflict-affected countries. Anecdotal evidence at times suggested otherwise, but policy efforts were observed to maintain supply chains in those countries. A high inflation trend in Egypt, the Sudan, the Syrian Arab Republic and Yemen continued in 2014. Hyperinflation in the Sudan and the Syrian Arab Republic was a direct consequence of their severe foreign exchange constraints relating to economic sanctions. Monetary factors continued to cause a high inflation regime in Egypt and Yemen.

22. The forecasted consumer price inflation rate of the Arab region for 2015 is 4.9 per cent. International commodity prices are projected to decline further, which will set the overall trend for the Arab region. The upward shift in the price of housing-related items in GCC countries is expected to taper off, lowering consumer price inflation in those countries moderately. Among high-inflation countries, the inflation rate in the Sudan is expected to decline considerably, owing mainly to expected lower import prices; the inflation rate in the Syrian Arab Republic is expected to rise, owing partly to a base effect under continuing severe foreign exchange constraints in a crisis situation. The structural high-inflation regime is projected to continue in Egypt and Yemen. Moreover, the possibility of hyperinflation cannot be ruled out for Yemen if the armed conflict intensifies further.

G. Exchange rates

23. Several Arab countries experienced a significant depreciation of their national currencies against the United States dollar in 2014 and up to early 2015. To varying degrees, the national currencies of the Maghreb countries — Algeria, Libya, Morocco and Tunisia — depreciated against the dollar in parallel with the rapid depreciation of the euro against the dollar in the second half of 2014. The Maghreb countries have traditionally maintained a stable exchange rate against the euro because the euro area constituted their main export destination. The national currencies of the Comoros and Mauritania also depreciated against the dollar for the

same reason. The national currency of Kuwait, which is pegged to a basket of currencies, including the euro, also depreciated against the dollar. The GCC countries, Djibouti, Iraq, Jordan and Lebanon have maintained the foreign exchange regime of a dollar peg. Egypt managed the orderly depreciation of the Egyptian pound from LE 7.0 to the dollar to LE 7.6 to the dollar. The Sudan also managed the value of its national currency, with a gradual depreciation to 6.1 Sudanese pounds to the dollar. The value of the Syrian pound continued to weaken during 2014, dropping from LS 160 to LS 220 to the dollar. For 2015, further devaluations of national currencies are projected for Egypt, the Sudan, the Syrian Arab Republic, Tunisia and Yemen owing to their weak balance-of-payment situations.

H. Social dynamics and employment

24. The most striking event characterizing the social dynamics of the Arab region is the mass displacement of populations, either internally or abroad, owing to intensifying armed conflicts. In 2014 and 2015, the number of displaced persons has shown a significant increase in Iraq, Libya, the State of Palestine, the Syrian Arab Republic and Yemen. The extent of displacement represents a humanitarian crisis in conflict-affected Arab countries. Moreover, the magnitude of the displacement is sufficient to hamper the future economic reconstruction of the countries concerned, given that it has already eroded human capital and social coherence. Social impacts were increasingly felt in Jordan and Lebanon, where demographic structures have been changed by the influx of Syrian refugees and evacuees, which strained health and education services. Both countries have absorbed the initial shock of rapidly increasing numbers of residents within their national borders but are struggling to maintain the level of welfare within ever-limited resources.

25. Unemployment rates remain at a high level in the Arab region. For the countries where data are available for the fourth quarter of 2014, the unemployment rates are as follows: Egypt, 12.9 per cent;[8] Jordan, 12.3 per cent;[9] Morocco, 9.7 per cent;[10] Saudi Arabia, 11.6 per cent among Saudi nationals;[11] and State of Palestine, 26.5 per cent.[12] Owing to the existence of an informal sector, the region's unemployment rate reflects structural employment gaps rather than cyclical gaps. The available rates, however, are not indicative of a significant structural change in the labour markets, with two exceptions. One exception is the significant deterioration of the employment situation in the State of Palestine, in particular in the Gaza Strip where the unemployment rate jumped from 32.6 per cent in 2013 to 43.9 per cent in 2014.[12] The armed violence in the Gaza Strip in July 2014 and the continuing restrictions on economic activities contributed to the worst employment situation in

[8] Central Agency for Public Mobilization and Statistics, press release, 16 February 2015. Available from www.capmas.gov.eg/pepo/779_e.pdf.

[9] Department of Statistics, press release, 22 January 2015. Available from www.dos.gov.jo/dos_home_e/main/archive/Unemp/2014/Emp_2014-q4.pdf.

[10] Haut-Commissariat au Plan, "La Situation du marché du travail au quatrième trimestre de l'année 2014". Available from www.hcp.ma/La-Situation-du-marche-du-travail-au-quatrieme-trimestre-de-l-annee-2014_a1504.html.

[11] Central Department of Statistics and Information, "Quarterly unemployment rate" data set. Available from www.cdsi.gov.sa/english/.

[12] Palestinian Central Bureau of Statistics, "Labour force survey (October-December, 2014) round (Q4/2014)". Available from www.pcbs.gov.ps/portals/_pcbs/PressRelease/Press_En_LFS-Q4-2014-e.pdf.

years. The other exception is the moderate improvement in the gender gap in employment in Jordan and Saudi Arabia in the recent past. The female unemployment rate in Jordan fell from its peak of 26.8 per cent in the third quarter of 2013 to 19.1 per cent in the fourth quarter of 2014.[9] The rate in Saudi Arabia fell from its recent peak of 35.7 per cent in the fourth quarter of 2012 to 32.5 per cent in the fourth quarter of 2014.[11] The labour nationalization policy in Saudi Arabia was stringently applied during 2014. In introducing new measures to restrict foreign workers by enhancing the Saudization system, introduced in 2011, Saudi Arabia actively promotes Saudi nationals seeking a career in the private sector. This trend was followed by other GCC countries. High youth unemployment, resulting from job shortages for a growing cohort of new labour market entrants, remains a critical socioeconomic issue throughout the Arab region.

IV. Policy developments

26. The scope of policy dilemmas has generally widened for policymakers in the Arab region. For the major energy exporters among the GCC countries, a rapid policy response was needed to cope with the fall in oil revenues and weakened fiscal positions. GCC Governments played a pivotal role in diversifying their economies by actively investing in non-oil-sector infrastructure, health and education. GCC Governments now face the policy dilemma of whether they should maintain the current level of public expenditure. Counter-cyclical fiscal measures may be needed to achieve the targeted economic diversity. In the meantime, however, lower oil revenues are likely to require budget cuts to maintain fiscal prudence. While foreign exchange constraints eased moderately as a result of declining international commodity prices, the Governments of other Arab subregions need to cope with tight fiscal constraints. Subsidy reforms have been implemented in stages in several Arab countries, including Egypt, Jordan, Morocco, the Sudan and Yemen, but fiscal positions remain structurally weak.

27. GCC countries maintained the same stance with regard to monetary policy as in the previous year, shadowing that of the United States Federal Reserve. No change in policy interest rates was seen in GCC countries in 2014. Reflecting this policy stance, funding costs in terms of the three-month interbank money market rate in GCC countries remained at around 1.0 per cent. Among other countries, the three-month Emirates Interbank Offered Rate continued to decline, reaching 0.67714 per cent at the end of 2014. The three-month Kuwait Interbank Offered Rate gradually rose to 1.3125 per cent in November from 0.875 per cent in January, before declining to 1.0625 per cent at the end of 2014. It is projected that the United States policy interest rate will be raised by the end of 2015 and the monetary stance of GCC countries is expected to change accordingly. Given that low inflation is projected, and there is a need to maintain economic stimulus amid lower oil revenues, however, the monetary authorities in GCC countries are likely to devise policy measures to lessen the anticipated negative impacts. Falling international commodity prices and increasing foreign capital inflows have created a sizeable policy space for monetary easing in Egypt, Jordan and Morocco. In Egypt, the central bank took a precautionary measure in July 2014 to cope with anticipated inflation by raising the policy interest rate by one percentage point. However, the Egyptian monetary authority moved back to a monetary easing stance in January 2015 by lowering the policy interest rates by one half of a percentage point when it

became apparent that the decline in commodity prices had eased foreign exchange constraints. In Jordan, the central bank took monetary easing measures in January and June 2014 and February 2015. The overnight window deposit rate, one of the key policy interest rates in Jordan, fell from 3.5 per cent in January 2014 to 1.75 per cent at the end of the first quarter of 2015. In Morocco, the central bank lowered its key policy rate — by 0.25 percentage points — in September 2014 for the first time since March 2012. Morocco lowered its policy interest rate again in December 2014 by another 0.25 percentage points. In Tunisia, the central bank maintained a tight monetary stance, mainly to cope with difficult balance-of-payment conditions, by raising its key policy interest rates by 0.25 percentage points to 4.75 per cent in June 2014. The Lebanese central bank actively utilized monetary stimulus measures, in line with its easing monetary stance. In the Syrian Arab Republic, the central bank attempted an orderly, gradual depreciation of its national currency while managing the demand for foreign currencies. The continuing armed violence in the country and the substantial devaluation of the Syrian pound notwithstanding, it is noteworthy that trust in the Syrian national currency has not been abandoned.

28. The fiscal balances in GCC countries changed substantially in 2014 with lower oil prices. Bahrain, Oman and Saudi Arabia are expected to register budget deficits in 2014 and more countries are likely to face budget deficits in 2015. In terms of budgetary planning, however, GCC countries are not projected to reduce government expenditure to the extent of fiscal austerity. Fiscal stances remain in the range from mildly active to neutral. Most expenditure cuts will be made by reducing extrabudgetary expenditure. Public investment in infrastructure and in the health, education and social spheres is expected to continue in selected prioritized areas. To improve fiscal management, Qatar has decided to move its fiscal year to a January-December cycle from an April-March cycle. Arab Governments in other subregions continue to aim at fiscal consolidation. Subsidy reforms progressed in several countries, including Egypt and Jordan, in 2014, but revenue prospects remained weak. Direct and indirect external assistance became more important for those countries to maintain the level of capital spending, including development projects. International capital markets have been accessible to countries in the Mashreq and Maghreb subregions for foreign borrowing. Jordan, Lebanon, Morocco and Tunisia raised funds through bond issuances in international capital markets in 2014.

V. Conclusion

29. The dramatic fall in oil prices marked a clear shift in the external economic environments of the Arab region. Oil wealth has been vital, not only for oil-exporting Arab countries but also because of the major spillover effect of oil wealth to oil-importing Arab countries. Oil wealth has been distributed over the region in the forms of capital, remittances and foreign aid. Lower oil prices benefit oil-importing countries in the region by improving their balance-of-payment conditions. As a secondary effect, however, lower oil prices may reduce capital, remittances and aid flows from GCC countries to the other Arab countries. The Arab region, on average, saw economic expansion in the past few years, the difficult geopolitical conditions, political instability and social unrest notwithstanding. Armed conflicts have intensified in Iraq, Libya, the State of Palestine, the Syrian Arab Republic and Yemen, while security has been frequently disrupted in Lebanon and Tunisia. The key pillar sustaining regional growth despite these prevailing negative factors had

been the growing oil wealth that allowed a certain level of intraregional flows of capital, remittances and aid to be maintained from the region's major oil producers among the GCC countries. While geopolitical tensions remain, this pillar of regional economic stabilization has begun to weaken. The overall structural impact of low oil prices remains to be seen, but current economic and non-economic events in the Arab region remain challenges to sustainable regional medium-term to long-term growth.

30. The Arab region has experienced a prolonged oil boom, which has lasted more than 11 years. The previous price plunge, caused by the global financial crisis in 2008, was swiftly reversed as markets witnessed a speedy recovery of demand from developing economies such as China and India. The rapid expansion of crude oil production in North America indicates a slow recovery of oil prices. By the end of 2014, oil market participants had realized that the price elasticity of crude oil supply had suddenly increased owing to advancing technologies for shale and tight oil extraction. The weak prospect of oil revenues and weakening oil wealth are likely to cause Arab countries to rethink their growth strategies. GCC countries were successful to a certain extent in their economic diversification strategy during the oil boom that began in 2003. The non-oil sector, especially the finance, telecommunications, transport and services sectors, registered remarkable growth. At the end of the oil boom, however, oil remained essential in GCC countries as a source of national wealth, government revenues, business confidence and economic sentiment. The challenge for GCC countries remains to devise a strategy of further economic diversification to reduce their dependence on oil. New diversification strategies may require effective labour nationalization policies, which affect employment opportunities for job seekers in other Arab countries. Efficient rebalancing in intraregional flows of capital and labour is needed for the benefit of Arab economies in both GCC countries and other Arab countries. Policy coordination efforts through regional cooperation are urgently needed to optimize the use of the region's human capital and financial wealth for a path to more sustainable regional growth.